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# CHAPTER ONE: INTRODUCTION

1.1 Vanuatu's highly dualistic economy comprised of some 80% of the population engaging in subsistence or small-scale agriculture, primarily copra, kava<sup>1</sup>, beef, cocoa, coffee and other root crops and timber production representing some 23% of the Gross Domestic Product. The formal economy, dominated by the services sector, includes government, tourism, wholesale and retail trade, and an offshore financial center<sup>2</sup> accounts for 66% of GDP. The value added of the industry sector is equivalent to 11% of GDP, and is relatively the fastest growing sector.

## **1.2 Agriculture**

Agriculture supports 80% of the predominantly rural population but contributes only 20% of GDP (1999). Its relative share declined from 29% (in 1983) to an estimated 20% in 1999. This decline is mainly due to the weakening of commodity prices and gradual diversification of the economy. The sector referred to as subsistence comprises of root crops, tropical fruits, coastal fishing, poultry and livestock. Copra remains the dominant cash crop followed by beef, kava, cocoa and some coffee, mainly in the southern islands. Copra price fluctuations and frequent cyclones<sup>3</sup> has an impact on the value added to the economy. There appears to be no alternatives to copra, and that it would continue to be the main cash income for the majority of the 79% rural population in many years yet to come. In 1999, it accounted for 5% value added and represented almost 50% of the country's principal domestic exports.

## **1.3 Industry**

The industry sector comprises of manufacturing, electricity and construction representing an estimated 11% of GDP in 2000. It is the fastest growing industrial sector. Its relative share grew from a mere 8% in 1983 to current levels. Relative growth in this industrial sector is attributable to the rapid growth in manufacturing and construction. Few cyclones occurred during the decade and caused major destruction to agriculture, infrastructure and buildings thereby necessitated major rehabilitation works and reconstructions. Manufacturing comprises mainly of food and wood products which are prospects for the tourist industry. The sector is constrained by its relatively high cost structure. The establishment of the Vanuatu Foreign Investment Board and the enactment of new legislation opening up new areas of previously restricted investment provides opportunities for liberal trade and a conducive investment environment.

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<sup>1</sup> Kava originates from the piper methysticum family and makes a psychoactive drink. It contains pharmaceutical products and has the following properties: antibacterial, antiseptic, antifungus, anaesthetical, relaxing, soporific, diuretic, reduce blood pressure, analgeziec and anticongestion and soothing pains in connection with Genito-Urinal system complaints.

<sup>2</sup> Offshore financial center consists of banks, accounting firms, insurance and trust companies, legal firms. Both domestic and offshore activities are included.

<sup>3</sup> Vanuatu, on average, sustains 2.6 cyclones a year and around 2,000 earthquakes with some having an impact of causing deadly tsunamis.

## **1.4 Services**

The services sector is by far the largest sector contributing 66% of the value of GDP. This comprises of government services, finance and insurance, transport and communications, wholesale and retail trade, hotels and restaurants and real estate and other services. In 2000, it is estimated that the sector represents 66% of GDP and it is projected to continue to dominate the economy. Tourism, in addition to being a predominant foreign exchange earner, is a significant sector in the overall economy of the country. It provided direct employment for 1,300 people in 1993 and it was estimated that Vanuatu earned US\$31.2 million in foreign exchange earnings, representing 18% of the value of GDP. Tourism earnings represent some 147% of total domestic exports valued at US\$21.2 million. Vanuatu's physical beauty, friendly population, cultural diversity, a pleasant climate, and easy access to Australia and New Zealand makes Vanuatu potentially good for further tourism development. Presently tourism development has been centered around the capital, Port Vila, and Luganville on the island of Santo. Dispersion of tourism activities throughout the country would enable generation of economic activities and provide opportunities for the predominantly 80% rural population.

The tax-free Offshore Finance Centre employs about 500 people, the majority being ni-Vanuatu<sup>4</sup> and contributes 12% of GDP. Economic benefits are derived directly from Government fees and local employment with its relatively high skilled ni-Vanuatu labour force. The OFC's primary attraction relates to its favourable time zone, tax regime and open policy exchange system. The Registrar of Companies has made salutary progress in recent years and with the enactment of the new Companies Act would facilitate easy and speedier incorporation of companies and replaces the memorandum of articles of association. This new arrangement also reduces the initial and ongoing costs of registering companies in Vanuatu. The shipping registry has also maintained a good reputation for quality and safety standards for its ships and operators. However its competitiveness has declined due to more attractive rates offered by other shipping registers (e.g Panama) resulting in Vanuatu losing its vessels over 35,000 tonnes. Changes to the Maritime Act (1981) have already been proposed. Vanuatu should also consider re-investing proceeds from fees in marketing the offshore financial centre in an aggressive way. Present marketing allocations are insufficient to make a real impact.

Government's share of GDP declined from 13.8% in 1983 to 9.4% in 1999. This decline is a result of government's efforts in containing expenditure and faster growth in other sectors.

## **1.5 Economic Potentials**

The economic potentials for development are basically land-based, viz. Agriculture and forestry. Throughout the years the Vanuatu people have accumulated experience in traditional agriculture. Application of new technology and introduction of suitable new crops would greatly assist in increasing production and expansion of the production base respectively. The three 'S's, sand, sun and sea with a tropical climate and a friendly population ensured tourism to be a major potential for the country.

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<sup>4</sup> Vanuatu nationals

## Tourism

Tourism by far poses the single greatest potential for opportunities creation and having a positive multiplier effect on the country's economic and social development. Survey results conducted by the regional Fiji-based Tourism Council of the South Pacific revealed Vanuatu's potential for tourism development. Vanuatu offers physical beauty and enormous cultural diversity, a very friendly population and relaxed atmosphere, a very pleasant climate all year around and very easy access to Australia and New Zealand. The country's remarkable history with unparalleled blend of French and British cultural influences makes Vanuatu clearly distinct from the other islands of the South Pacific. This shows the potential that the country can develop into a major tourist destination in the South Pacific.

Vanuatu saw the need to have its own aircraft, purchased a 727 jet aircraft in 1989 thereby establishing an international airline, then later sold it to purchase a 737 aircraft. Air Vanuatu operated six flights a week to Australia and two flights a week to New Zealand. It has successfully negotiated seat-sharing deals with two Pacific airlines for the Noumea-Vila, Nadi-Vila and Auckland-Vila routes. Excursionists<sup>5</sup> visiting Vanuatu on cruiseships, yachts and by air totaled 44,853 in 1999 while tourists<sup>6</sup> amounted to 50,742 during the same period. With the inclusion of other excursionists, total visitors was equivalent to 95,674.

**Table 1: Visitor Arrivals by Purpose of Visit and Year**

<b>Year</b>	<b>Pleasure</b>	<b>VFR</b>	<b>Busines</b>	<b>Other</b>	<b>Total Tourist</b>	<b>Day Visitor</b>	<b>TOTAL VISITOR</b>
1995	31,340	3,209	6,390	2,045	43,721	58,020	101,004
1996	33,652	2,944	5,833	2,757	46,123	58,044	103,230
1997	36,194	3,440	5,992	2,713	49,624	32,608	80,956
1998	39,441	3,076	6,081	2,790	52,087	26,427	77,815
1999	37,725	4,262	5,649	1,306	50,742	46,732	95,674

Source: Statistics Office, Statistical Indicators, First Quarter 2000

A new passenger terminal was constructed with funding support provided by the Japanese Government. Vanuatu has recently embarked on the upgrading of the Port Vila Bauerfield International Airport to enable it receive 767 aircrafts. This should boost the air capacity of international flights. On the southern island of Tanna, another international airport capable of handling 60 seater aircrafts was constructed. In Luganville<sup>7</sup>, upgrading works to the airport to permit receipt of 737 aircrafts has already began and is expected to be completed by end of 2000. Five island domestic airports to be tarmac-sealed with funding support from France and the European Union is due to start towards end of this year.

## Agriculture

Vanuatu will continue to rely on agriculture<sup>8</sup> as the provider of cash income for the mainly rural population and as a principal export source of revenue as well as the main

<sup>5</sup> Day visitors who do not stay overnight in the country comprising of passengers on cruiseships, yachts and airline passengers who stopover to change flights.

<sup>6</sup> Visitors staying in the country for at least one night and not more than one year.

<sup>7</sup> Second largest town on the island of Espiritu Santo

<sup>8</sup> This includes copra, beef, kava, cocoa, coffee and other subsistent production, and fisheries.



provider of employment for 75% of the population. Land is valued as the most important asset by all ni-Vanuatu and this is demonstrated by the inclusion of land ownership rights being enshrined in Vanuatu's constitution. The agriculture system is a mixture of subsistence farming and cash cropping. Ni-Vanuatu's involvement in agriculture cash economy has noticeably increased since independence. The agricultural activities revolve around production of copra, beef, cocoa and kava for export and additional food crop and vegetables production for subsistent livelihood and local markets.

**Table 2: Value of Principal Domestic Exports By Year (in million vatu)**

<b>Principal Exports</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>
<b>Copra</b>	1,100	1,240	2,004	1,704	1,384
<b>Beef Veal</b>	427	430	418	325	404
<b>Cocoa</b>	126	175	240	165	148
<b>Shells</b>	101	90	85	89	77
<b>Sawn Timber</b>	252	358	513	521	363
<b>Cowhides</b>	56	47	56	37	27
<b>Kava</b>	48	64	102	888	379
<b>Coffee</b>	7	10	14	8	2
<b>Other products</b>	434	296	133	171	124
<b>TOTAL</b>	<b>2,551</b>	<b>2,709</b>	<b>3,565</b>	<b>3,907</b>	<b>2,907</b>

Source: Statistics Office, Statistical Indicator, 1<sup>st</sup> Quarter 2000

Traditionally copra has been the mainstay export crop for Vanuatu and has been the main source of generating cash income for most ni-Vanuatu people. In 1999 it represented almost half (48%) of the total value of domestic exports. The Government established the Vanuatu Commodities Marketing Board in 1981 to buy, sell and stabilize prices paid for prescribed commodities i.e copra, cocoa and kava. Under the ADB-sponsored CRP<sup>9</sup>, these commodities were de-prescribed providing opportunities for competition and allowing foreign investment in these areas. A project currently being designed for funding through multi-lateral loan is purposed to assist facilitate creation of economic activities in rural areas and enable access to larger markets.

Beef is the second most important export commodity besides copra. Vanuatu's beef is considered to be one of the best in the world. Vanuatu is the only Pacific island state that exports beef. Cattle production has often been used complimentarily in the coconut production to maintain areas under coconut trees clean. As can be seen from Table 2 above, beef exports has often been maintained around the VT400 million mark until 1998, when the value of exports drastically fell to VT325 million due to the temporary closure of the Santo abattoir and impact of cyclone destruction. Beef and its potential as an export commodity is well recognized by Government, and in the Third Development Plan (1992-1996), it identified various developments that occurred in the sector:

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<sup>9</sup> CRP – Comprehensive Reform Programme introduced in 1997 to renew institutions of governance, redefine the role of the public sector, improve public sector efficiency, promote private sector-led growth and improve equity.

- A sector review (1985) and marketing study (1991);
- Vanuatu Officials visited Japan (1988) to negotiate arrangements for the export of Vanuatu's beef to Japan and expansion of this market;
- Establishment of Small Holder Cattle Development Project, Phase II in 1988 (VT28 million) until 1992;
- Establishment of Pastures Improvement Project (VT27 million) and extension (VT108 million) until 1993;
- Provision of veterinary and meat inspection services;
- Implementation of TB and Brucellosis control project (VT28 million);
- Upgrade of Port Vila Abattoir (VT107 million).

Kava, is a traditional crop grown by some Pacific island nations, which is used to make a relaxant and psychoactive drink. The Vanuatu kava, comprising of some 60 varieties, is of particularly high quality. The statistics shown in Table 2 indicates clearly the potential that kava offers as a major commodity export. In recognizing the importance of kava, Government has de-prescribed it and had undertaken two research studies on the crop's agronomy and its marketing opportunities. The dried form is exported to the European Union for pharmaceutical industry while the fresh roots are exported to nearby New Caledonia, Pacific island countries and Australia.

Cocoa used to be the third largest agricultural export but has now been overtaken by kava. The Third Development plan highlighted developments in this sector to be:

- Establishment of the Metenesel Cocoa Estate on the island of Malakula;
- Establishment of Cocoa Development project Phase I until 1986 (VT23 million) and Phase II (VT114 million) in 1992;
- Establishment of Cocoa Fermentaries Project until 1985 (VT9 million);

Last year the Producers Organization project was established charged with developing marketing initiatives for cocoa production and other agricultural commodities.

### Forestry

Vanuatu has abundance of forests suitable for timber. When the Government established the Department of Forestry it gave it the following duties:

- Establish, coordinate and maintain Local Supply Plantations (LSP);
- Establish large-scale Industrial Forestry Plantations (IFP);
- Control logging operations by establishing logging practices;
- Forestry research.

Recent developments saw the establishment of the Espiritu Santo IFP with an estimated 525 ha of land planted. In DP3, Government highlighted the constraint of attracting prospective investment in this sector. This constraint was short-lived as already foreign investment has establishes itself under the industrial forest plantation programme using the Clean Development Mechanism.

Vanuatu banned export of unprocessed logs in 1990 resulting in increased processing and saw milling units being established, creating additional employment opportunities and creation of value added per unit of timber exported. This sector grew positively during 1986 to 1991 and continued to grow thereafter. About 15 companies were established to process timber and providing employment for some 500 persons.

## **1.6 Overview of Major Constraints on Development in 1990s**

Vanuatu, like other Pacific LDC island states, do not engage in drawing up National Development Plans like it used to. Instead it engages in the development of reform strategies. Development partners were also in tuned with this type of approach and provided financial support to this cause. The reforms took place as a result of continuing economic stagnation, poor social services, increasingly unstable government, inefficient public administration and the abuse of power. Secondary to these, the reforms were instituted to enable Vanuatu pursue compatibility with global trends in international competitiveness, free trade and deregulation and shrinking protectionism.

In the strive towards an increased quality of life for all, the economy has not been performing any better during the last decade. The CRP document identified the following reasons constraining expected economic performance and growth to be:

- Inadequate investment in human capital, which has kept the country short of skills and dependent on costly expatriate labour;
- A low rate of investment by the private sector;
- Low returns on public investment, mainly because of poorly chosen projects;
- A generally poor management in areas under Government influence, largely because of poor skills transfer from expatriates and the appointment of senior managers on the basis of political affiliation rather than ability;
- A cost structure for business making Vanuatu internationally uncompetitive;
- Continuity of the duality of the economy, with inadequate linkage between the rural and urban sectors; and consequently a slow rate of transfer of commercial attitudes and skills to the rural ni-Vanuatu population.

Additional to the above the following were identified as impediments to socio-economic development:

- Frequent occurrence of natural disasters, e.g cyclones, earthquakes and tsunamis, volcanic activity and acid rain;
- Land tenure system and disputes;
- Political instability and interference;
- Geographical dispersion and remoteness from major markets and large distances from constituent islands;
- Unequitable development biased towards urban centers;
- Overseas Development Assistance and its conditionalities;
- Institutional weaknesses and lack of managerial and technical skills;
- High cost structure of economy;
- Narrow revenue base
- Public Service Strike (1994) and VNPF Riot (1997)

### Natural Disasters

The high frequency of weather-related disturbances has serious short and long-term impacts on the lives of the Vanuatu people. Vanuatu's vulnerability to natural disasters was estimated by the Commonwealth Secretariat to be ranking highest among 111 developing countries, on the basis of the percentage of population affected by disasters during the 1970-1996 period. On average 2.6 destructive tropical cyclones occur annually. The last tropical cyclone (Dani) devastated Vanuatu in 1998 and the cost is estimated at approximately 20% of the national budget. Much of the required rehabilitation works on infrastructure have not been completed to date. Funding of major works is being funded by donors and through a US\$2 million loan from ADB. Post-disaster relief assistance is constrained by the problem of rural islands' remoteness to the only two urban areas<sup>10</sup>. This structural handicap makes emergency assistance difficult as inter-island shipment is not regular. Post-disaster relief assistance can be extremely expensive when deliverance of medical and food items are made employing helicopters or planes.

Natural disasters not only constitute economic instability but also depresses export earnings. Vanuatu is severely affected by external shocks, in terms of sectoral specialization and economic structural handicaps, in its efforts to pursue planned economic development. Because of the frequency of incidence of natural disasters the economy does not recover fully until another one strikes. This creates problems in achieving the fruits of economic development planning.

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<sup>10</sup> Port Vila is on the island of Efate and Luganville is on Santo

**Table 3: Major Cyclones By Socio-economic impact since 1985**

Cyclones	Estimated Reconstruction Costs (in US\$)	Comments
Eric, Odette and Nigel 13-28 Dec 1985 (duration: 16 days)	1 million (2% of National Budget)	Rural provinces severely affected: Torba 9 persons killed, thousands of homeless people, crop destruction. Emergency food aid and other emergency humanitarian relief assistance received from donors.
Uma 3-8 Feb 1987 (duration: 6 days)	150 million (300% of National Budget)	Whole country severely devastated with Port Vila (capital) sustaining most damage. Emergency food aid and other emergency humanitarian relief assistance was received from donors. 48 persons were killed. 15,000 homeless, 3 international vessels sank, 40 boats sunk in Port Vila harbour, considerable damages were inflicted on buildings and the infrastructure (roads, bridges, schools, government buildings, tourism facilities, houses, etc. and on crops.
Anne 7-14 Jan 1988 (duration 8 days)	2 Million (4% of National Budget)	Rural provinces severely affected. Torba in Torres Islands where almost all islanders lost their houses and cash crops. Sanma (Santo Island) and Tafea – destruction of their main wharf. Emergency food aid and other emergency humanitarian relief assistance was received from donors. 3,200 persons were affected.
Bola 25 Feb-4 Mar 1988 (duration 7 days)	About 5 million (10% of National Budget)	Rural provinces severely affected. Shefa (Sheperd Islands, Epi), Malampa (Paama, Malekula, Ambrym). Emergency food aid and other emergency humanitarian relief assistance were received from donors. 3,000 households and more than 15,000 people were affected. Widespread damages were incurred by local houses, government buildings, roads and bridges. Adverse effects were felt on crops. Ships went aground and one barge carrying building materials for a new wharf in Malekula sank (estimated loss about A\$4 million)
Ivy 23 Feb–2 Mar 1989 (duration 9 days)	n.a	Rural provinces severely affected. Tafea (Aneityum). Emergency humanitarian relief assistance was received from donors. Substantial damages were incurred by crops, houses, tourism facilities and forestry plantations.
Betsy 7-11 Jan 1992 (duration 5 days)	n.a	Rural provinces severely affected. Malampa (Ambrym, Malekula; Shefa (Epi, Shepherd Islands, Efate). Emergency food aid and humanitarian relief assistance was received from donors. One person was killed.
Fran 8-10 Mar 1992 (duration 3 days)	n.a	Rural and urban provinces severely affected. Shefa (Efate, Tafea (Erromango). Buildings in Port Vila suffered major damages.
Prema 29-30 Mar 1993	6 million (12% of National Budget)	Rural and urban provinces severely affected. Shefa (Efate, Shepherd islands, Tongoa). Emergency humanitarian relief assistance was received from donors. 4 persons killed, 5 injured, 12,000 persons affected of whom 7,000 were left homeless. Considerable damages were inflicted on agriculture, tourism, housing and public buildings.
Sarah 25-28 Jan 1994 (duration 4 days)	n.a	Rural provinces severely affected. Shefa (Efate), Tafea (Tanna, Aneityum). Emergency humanitarian relief assistance was provided by donors. Damages were inflicted on crops and buildings. On Tanna the Lenakel wharf (main) was destroyed (reconstruction cost estimated at US\$0.5 million).
Thomas 26-27 Feb 1994 (duration 2 days)	n.a	Rural province severely affected. Shefa (Efate). There were damages to coastal sea walls on Efate and in Port Vila due to very heavy seas. The road over Eastern Efate was impassable due to deposited sand.
Susan 4-7 Jan 1998 (duration 4 days)	n.a	Rural and urban provinces severely affected. Torba and Sanma. Damages were caused to buildings, crops and livestock; heavy rainfalls caused rivers to overflow.
Yali 18-23 Mar 1998 (duration 6 days)	n.a	Rural provinces severely affected: Tafea. Damages to agriculture and infrastructure. Rivers overflow.
Zuman 30 Mar-2 Apr 1998 (duration 3 days)	n.a	Rural and urban provinces severely affected. Torba and Sanma (Santo). Emergency food aid and emergency humanitarian relief assistance was provided by donors. 2,400 persons were affected. There were damages to agriculture and infrastructure. 200 houses were destroyed; 80% of the crops were damaged; roads sustained heavy damages.
Dany Feb 1999	10 million (20% of National Budget)	Rural and urban provinces severely affected. Shefa (Efate), Malampa (Malekula), Sanma (Santo), Penama (Pentecost, Ambae, Maewo). Damages were suffered by buildings, roads, bridges, tourism facilities and agriculture.

Source: UNCTAD Vulnerability Profile of Vanuatu; Vanuatu Meteorological Office, Vanuatu Government, Port Vila

In UNCTAD’s report on the Vulnerability Profile of Vanuatu, it stated that “*Vanuatu is located on the ‘Pacific rim of fire’, a subduction area where the Indo-Australian and Pacific tectonic plates are constantly in contact. The archipelago hosts at least 15 volcanoes (exposing several inhabited islands to high risks of destruction) and experiences some 2,000 earthquakes per year<sup>11</sup> while absorbing 10% of the world’s total energy released by quakes*”.

In November 1999, an earthquake measuring 7.3 on the Richter Scale followed by a 30-foot tsunami killed 10 persons and caused the displacement of over 1,000 persons on the rural islands of Pentecost and Ambrym. One ship was sunk and the limited infrastructure was severely devastated under the impact of widespread landslides. Rehabilitation works are still being undertaken to date.

**Table 4: Major Earthquakes in Vanuatu since 1980**

Period of Occurrence	Magnitude on the Richter Scale	Comments
July 1980	8	US\$500,000 damages
October 1980	7.2	Cost of damages not known
July 1981	7.0	Cost of damages not known
September 1981	6.7	Costs of damages not known
February 1990	6.7	Cost of damages not known
March 1990	7.0	Cost of damages not known
July 1990	6.8	2 persons injured, structural damages inflicted on buildings on island of Santo
November 1999	7.3	7 persons were killed (plus another 3 by ensuing tsunami) and structural damages were inflicted on the infrastructure, education and health facilities on Pentecost.

Source: Univesite Catholique de Louvain and UNCTAD’s report on Vulnerability Profile of Vanuatu, 1999

#### Land Tenure System and Problems

At independence in 1980 the constitution declared “*all land in the Republic belongs to the indigenous custom owners and their descendants*” and revoking all previous arrangements. As land is one of the factors of production, it is invariably the essential pre-requisite for economic development. The land tenure system provides difficulty in transferring land to alternative uses and is seen as a strong disincentive for long-term investment. Under DP3, it identified existing disputes over the ownership of customs land as the largest single obstacle to the development of rural areas. The Island Courts system established to preside over land issues and cases is hindered by inadequate funding provided for by the Judiciary. The need for land reforms is most urgent to enable establishment of clear land ownership, allowing leases to be issued, transferring and using land as collateral for borrowing.

Agriculture and tourism are two important potential sectors of Vanuatu’s economy where land problems continue to prevent their rapid expansion and development into rural areas. Government intervention must bring about settlement of over 3,000 backlog land cases and establish a system of settling land disputes, negotiations and surveying. The lack of policy transparency in ensuring rural peoples’ understanding of Government policy relating to land is also a constraining factor.

<sup>11</sup> ef. ORSTOM, “Seismicite et risque volcanique a Vanuatu”, 1983

### Political Instability and Interference

During the 1980 to 1990 Vanuatu experienced political stability until 1991 when coalition governments were established. In 1996, three different Governments were formed. Political change brings about discontinuity and lack of application of good governance principles. Information from outgoing governments is not made available to incoming governments thereby disallowing Government employees from pursuing policy initiatives created by earlier governments.

As governments desire to involve themselves in the day-to-day operations of Government and public sector entities, political appointments (often professionally unqualified) were made. These appointments were based on individual's political affiliation and narrow political considerations and not on qualification and experience based. ADB stated in its report, '*Vanuatu Economic Performance, Policy and Reform Issues*' that their major conclusion "*is that political reform is the single most important requirement for Vanuatu to achieve improved social and economic performance*".

### Geographical dispersion and remoteness

Vanuatu's islands are widely dispersed in a Y-shaped archipelago, stretching some 850 kilometers. Marketing of agricultural products is constrained by the frequency, type and cost of inter-island shipping. The main islands in Sanma, Shefa, Malampa, Penama and Tafea (only Tanna) provinces receive regular shipping calls. Other islands, particularly Torba province are served very infrequently (sometimes it takes months for Torba) due to economic reasoning.

UNCTAD in its report on '*Vulnerability Profile of Vanuatu*' stated that "*the structural economic handicaps that Vanuatu, like most other small island developing states, suffers from essentially relating to the disadvantages of smallness and remoteness, and are aggravated by the geographical dispersion of the islands making up the Vanuatu archipelago. These handicaps stem from a general failure to enjoy economies of scale; serious limitations to production and export diversification because of high unit costs and shortages of skilled human resources; difficulties in importing inputs in, and exporting outputs from the smaller or more peripheral islands, in particular, because of the unsteadiness and costs of transport, which are obstacles to inter-island trade, including those at regional level; and obstacles to geographic equity, through the archipelago, in the distribution of social services.*" These dispersal of small population in several settlements across the archipelago add to the limitations for opportunities for internal and external trade. Infrastructure is costly and difficult to maintain.

### Inequitable Distribution of Development

Vanuatu's major problem is its incapability of transforming the subsistence communities (comprising of 80% of population) with their rich traditional and cultural values into a more commercially oriented sector if the economic aspirations of the population are to be realized and achieved. The benefits of development have not been evenly spread through the islands. Thus far, development has often been centered around urban areas. This unequal distribution of development has adversely impacted on population distribution and urbanization growth and their related problems. It is clear that given the amount of development aid available to Vanuatu, the performance of the economy and the successes of Government policies have not met the aspirations of the people. This problem must be immediately addressed as lessons learnt from other Pacific neighbours suggest that unequal distribution of development could

escalate into rise in criminal activities and ethnic problems given the wide diversity of the cultures of the Vanuatu people.

One objective of the five-year plan under DP3 called for “*development that leads to a greater balance between regions.*” Ground rules established by DP3 to enable it translate this theme into reality recommended community participation in development. This view is also consistent with the principles of CRP and current Government’s practices. In Dr Fallon report on ‘*The Vanuatu Economy, Creating Conditions for Sustained and Broad Based Development*’ published by AIDAB (now Ausaid) stated “*If the Government is to be successful in creating conditions for sustained and broad based development, the most important priority is to achieve firm commitment to a coherent and disciplined approach to policy formulation and implementation.*”



### Official Development Assistance and Conditions

Vanuatu is beneficiary to ODA funds provided through both bilateral and multilateral arrangements. Table 5 below provides information on development assistance received officially by Government through its database system maintained at DESD<sup>12</sup>. In 1992 total development assistance made available to Vanuatu was equivalent to VT3,716 million (about US\$28.6 million) of which 82% were provided in the form of grants and the remaining 18% representing loans. As can be seen from Table 5, these proportions fluctuated over the period under observation so that in 1999 the proportion of development funding through loans increased to 31% from 18% in 1992. Government has recently been cautious in its approval of loans offered by donors. A debt strategy and management is being considered. Grant funding must be the first source followed by borrowing from the domestic market. External borrowing must only be pursued as a last resort. In ADB's report on '*Vanuatu, Economic Performance, Policy and Reform Issues*' stated "*Clearly, the current trend of adding 20 percent of GDP to external debt each decade is not sustainable in the long-run. Vanuatu will need to develop an external debt strategy and carefully assess future borrowing to avoid the pitfalls that many other nations have fallen into.*"

While Vanuatu recognizes the importance that foreign aid support plays in stimulating socio-economic development and growth, there are issues that require review and attention.

- Establishment of the Government Investment Programme (GIP) provides the framework for donors and Government interventions. However, development partners only fund projects that fall within their priority area. There are times when priority areas of Government are not necessarily the same with donors. In this circumstance, usually donor's priority takes precedence. This contributed to unfunded projects. Unfunded GIP projects is to date valued at US\$145 million.
- The characteristics of Technical Assistance form of development assistance is that it has heavy cash outflow. The share of technical assistance is incredibly huge amounting to 36% of total ODA in 1992. This share is believed to have increased dramatically with the introduction of the adviser-driven reform programme. Quality of the technical assistance is also an issue that requires immediate addressing and expected expertise transfer to local counterparts is difficult to justify. Sustained economic growth and skills transfer is difficult to achieve in an environment where expatriate advisers dominate and influence decision-making. This impacts on the continual dependency on foreign technical assistance.
- Donor procedures are cumbersome. There is a burning desire by donors to funding civil society and the private sector directly. Such a system has the potential of undermining Government's coordination role. Government viewed it as an interference in its internal affairs.
- Many development loans, particularly those from multilateral partners, have conditions which require inputting specific programmes (or projects), which are resource and time-bound, to enable the country meet these specific loan conditions. Recent development loans were donor-initiated.
- Many development programmes implemented in Vanuatu were initiated by development partners and Vanuatu being asked to implement them.
- There was also lack of absorption capacity on Vanuatu's part to effectively utilize aid.

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<sup>12</sup> Department of Economics and Social Development (formerly National Planning Office), Vanuatu's aid focal point and coordinator and manager for all foreign aid, except ADB's which has direct contact with line ministries.

**Table 5: Value of Official Development Assistance By Year  
(in million vatu)**

<b>DONOR</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>
Australia	889	891	934	957	964	862	1,023	1,121
% Grant	100	100	100	100	100	100	100	100
% Loan	0	0	0	0	0	0	0	0
France	478	497	443	987	1,043	681	1,211	1,105
% Grant	100	100	100	94.5	100	100	100	100
% Loan	0	0	0	5.5	0	0	0	0
European Union	240	425	312	449	584	605	152	817
% Grant	100	100	100	100	100	100	100	17.3
% Loan	0	0	0	0	0	0	0	82.7
New Zealand	321	292	286	333	314	349	375	383
% Grant	100	100	100	100	100	100	100	100
% Loan	0	0	0	0	0	0	0	0
Japan	78	80	773	1,464	266	797	398	0
% Grant	100	100	100	100	100	100	100	
% Loan	0	0	0	0	0	0	0	
United Kingdom	713	567	338	319	n.a	267	191	135
% Grant	100	100	100	100		100	100	100
% Loan	0	0	0	0		0	0	0
China	178	21	62	506	56	176	163	110
% Grant	0.6	38.1	0	0	100	57.4	2.1	100
% Loan	99.4	61.9	100	100	0	42.6	97.9	0
ADB	77	123	150	198	1,477	20	0	675
% Grant	37.7	23.6	18.7	6.6	10.0	100		0
% Loan	62.3	76.4	81.3	93.4	90.0	0		100
World Bank/IDA	431	33	96	7	117	39	54	0
% Grant	0	0	0	0	0	0	0	
% Loan	100	100	100	100	100	100	100	
IMF	29	29	28	18	0	0	0	0
% Grant	100	100	100	100				
% Loan	0	0	0	0				
Canada	-	23	9	23	0	0	0	0
% Grant		100	100	100				
% Loan		0	0	0				
UN agencies	282	173	199	210	47	108	130	0
% Grant	100	100	100	100	100	100	100	
% Loan	0	0	0	0	0	0	0	
<b>TOTAL</b>	<b>3,716</b>	<b>3,154</b>	<b>3,630</b>	<b>5,471</b>	<b>4,869</b>	<b>3,904</b>	<b>3,698</b>	<b>4,346</b>
% Grant	82	96	92	86	70	97	91	69
% Loan	18	4	8	14	30	3	6	31

Source: Department of Economics & Social Development, Aid database

### Institutional Weaknesses and Incapacity

To reform the public sector is to accept that there exists weaknesses in the institutions of governance, public sector inefficiency and not understanding the role of the public sector.

These foregoing are the main features of the ADB-sponsored Comprehensive Reform Programme (CRP) introduced in 1997. Many Government departments are weak due to incapacities and inabilities of individuals appointed to positions not on the basis of merit but rather on their political affiliation and nepotism-based. Many of whom do not acquire technical, entrepreneurial and managerial skills. There were also structural weaknesses of establishments and the Public Service must be able to be action-oriented.

Past financial management was weak. The CRP document stated “*Money has been wasted; money owed to Government has not been collected; tax revenues are declining relative to GDP; and many public investments have been unproductive. New legislation is needed to correct these problems, together with a new budget system (‘programme budgeting’ from*

1/1/98, progressing to 'output budgeting' as soon as possible) and a more rigorous approach to budget management". Government expenditure was allowed to grow continually without constrain resulting in increasing budget deficits thereby depleting reserves; no additional revenue to finance ever growing debts; ineffective parliamentary scrutiny of financial policies and performance.

### High Cost Structure of the Economy

In an increasingly competitive world, costs of establishment and operation are important considerations for foreign investment. The lack of a one-stop-shop concept presented a somewhat investor-unfriendly interface with Government. The high costs of establishing and operating business in Vanuatu scare potential investors from coming to Vanuatu. These costs are associated with mainly the provision of the public utilities (electricity, water and telecommunications). These utilities are provided by two private locally registered companies, UNELCO<sup>13</sup> and TVL<sup>14</sup>. Both companies enjoy monopoly power in the provision of utility services. Their rates are considered some of the highest in the South Pacific.

Also Government is over-reliant on import duties to finance its recurrent operations and as a result import duties are relatively higher in Vanuatu. Broadening the tax base (alternate taxes) and lessening the reliance on import duties in the tax base would be an option to improve cost competitiveness. Access to capital is a problem particularly so for locals. This problem is compounded with high interest rates making it difficult to borrow to finance investment. Wide margin between deposits and lending interest rate exist and is argued to have led to reduced capital growth and constrained productive investment. ADB<sup>15</sup> stated "*Clearly the interest margin in Vanuatu is on the high side compared with other island economies, but not the highest in the region.*" Further, inefficient public service imposes extra unnecessary costs on the economy.

The income differential between locals and expatriate residents is very wide. The 1985 Family Income and Expenditure Survey revealed that the average income of expatriate residents is 7.5 times that of the locals. High expatriate income has an impact on increasing overall costs.

### Public Service Strike and VNPF Riot

The 1994 civil servants strike for higher wages lasting for over 12 months has seriously harmed the fragile economy. Delivery of government services were seriously affected. Essential Government services, except the police, also participated in the strike. The strike was viewed by the two-year old Government as politically motivated. The Government reacted by dismissing all Government employees participating in the strike and replacing them with unprofessional and inexperienced staff to continue to maintain Government services. The strike adversely impacted on revenue collection, service delivery and maintenance of law and order. Government being the largest employer, the dismissal of its employees had adverse multiplier-effect on the overall economy.

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<sup>13</sup> French Company – ELYO . Government holds one-third shareholding in the company. UNELCO has monopoly power over provision of electricity and water services.

<sup>14</sup> TVL – Telecommunication Vanuatu Limited with French Radio (one-third shareholding), Cable & Wireless (one-third shareholding) and Vanuatu Government (one-third shareholding). TVL has monopoly power in provision of domestic and international telecommunications.

<sup>15</sup> ADB report on 'Vanuatu, Economic Performance and Reform Issues'

In 1997, members of the Vanuatu National Provident Fund (VNPF) rioted in the capital, Port Vila and rampaged the VNPF Building and caused disastrous damage to some business community worth millions of dollars. The publication by the Vanuatu Ombudsman of the 'Public Report on the Vanuatu National Provident Fund – Housing Loan Scheme' which highlighted the extent of abuse of members funds in housing loans with values of one-third of the total VNPF assets, which stood at VT2.5 billion (or about US\$18.6 million) in 1994, triggered the riot. Government then approved payment of members contributions worth VT 3.3 billion (or about US\$25.4 million). The VNPF depleted its savings and Government had to borrow commercially an additional VT1.6 billion (or about US\$12.3 million) to meet total members demands. This has disastrous impact on increasing liquidity in the economic system and caused subsequent increases in imports which resulted in increased demand for foreign exchange.

In exercising its monetary responsibility, the Reserve Bank of Vanuatu (RBV) acted promptly in efforts to absorb the extra liquidity and assist in the sale of government bonds<sup>16</sup>. The RBV replaced the statutory reserve deposit (SRD) requirement of 10% against vatu assets with a 16% prescribed reserve asset (PRA) requirement. The RBV issued, at the same time, its own Reserve Bank notes with a 91 day maturity. RBV also raised its minimum lending rate, from 5% to nearly 11%. These measures were necessary to restore confidence and reduce pressure on the exchange rate. In November 1998, RBV re-introduced the SRD at 10% rate on vatu deposits and reduced the PRA to 6%.

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<sup>16</sup> These were needed to finance, in part, the VNPF payout.

## CHAPTER TWO: PERFORMANCE IN THE 1990s

While the economic growth rate has been modest during the past decade with negative growth during some years, population growth continues to increase at a consistent faster rate of 3.0% per annum. This resulted in living standards becoming stagnant and per capita income declining in real terms. Some worthy features of the poor economic performance in the 1990s are the public service strike in 1994 and its disastrous impact on economic activity, and the VNPF<sup>17</sup> members riot in 1997 which has almost crippled the country. Both incidents had macroeconomic impact of amplified magnitude as detailed under Chapter One of this report.

Despite this, Vanuatu was able to maintain macroeconomic stability throughout the 1990s with reasonable inflation rate averaging between 3 to 4 percent and gross international reserves equivalent to 5 to 6 months of import cover. While the debt service ratio can be acceptable, the continual adding of debt at a rate of 20% per decade appears unsustainable.

### **2.1 Economic Growth**

The economy grew at an average annual growth rate equivalent to 2.3% during the periods from 1990 to 1999. This rate is relatively slow compared to many countries in the Pacific rim so that an averaged citizen is hardly better off than a decade ago. Whilst economic growth rate has been slow, population growth momentum is maintained at 3.0% per annum. Real GDP per capita in 1990 was US\$586, deteriorating to US\$556 in 1999. This stagnating growth resulted in the Government acceptance of introducing a comprehensive reform programme in 1997 which emphasized private sector-led growth. The slow growth is reflecting the vulnerability of the economy to the influence of external factors. The UNCTAD prepared report on '*Vanuatu Vulnerability Profile*' states that "*Vanuatu is prone to a high frequency of natural disasters, and is also affected by the economic shocks of non-natural origin. These shocks have caused instability in the agricultural production and exports of the country, as well as in the performance of the tourism sector.*"

In 1999, the economic rate of growth was -2.2% when measured at constant prices as a percentage change from the previous year. This negative growth is attributable to mainly the agriculture sector which saw a decline by 8.8% combined with a 1.0% decline in the services sector. Unfavourable weather conditions during the latter part of the decade hampered both agriculture and tourism. Despite the poor performance, Vanuatu's economy expects to turn around and grow at 4% during 2000, with the major contribution by the industry sector when pipelined major infrastructure projects are implemented; and thereafter maintained constant at around 3% per annum.

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<sup>17</sup> VNPF – Vanuatu National Provident Fund Members riot resulted in Government approving full payment of members contributions.

**Table 6: Economic Growth (% Change) By Main Sector and Year**

MAIN SECTORS	1999	2000	2001	2002
<b>Agriculture, fishing and forestry</b>	-8.8	2.9	3.2	4.0
<b>Industry</b>	7.3	12.9	-0.4	-6.0
<b>Services</b>	-1.0	3.1	4.3	4.0
<b>Gross Domestic Product</b>	-2.2	4.0	3.5	3.0

Source: DESD, *Half-Year Economic and Fiscal Update, 30 June 2000*, MFEM

Official statistics on GDP are published only up to 1995, thereafter, estimates used are only provisional. The national Statistics Office charged with the responsibility, amongst others, of publishing sets of national accounts lacked expertise in maintaining the series, therefore caution must be exercised in interpreting provisional figures, especially when statistical discrepancy varies between VT175 million (or US\$1 million) and VT1 billion (or US\$8 million).

**Table 7: Real Gross Domestic Product By Kind of Economic Activity and Year  
(in Millions of Vatu, otherwise stated)**

	1990r	1991r	1992r	1993r	1994r	1995	1996p	1997p	1998p	1999p
AGRICULTURE, FISHING AND FORESTRY	<b>2,566</b>	<b>2,855</b>	<b>2,734</b>	<b>3,034</b>	<b>3,102</b>	<b>3,152</b>	<b>3,297</b>	<b>3,457</b>	<b>3,691</b>	<b>3,367</b>
Copra	668	545	530	544	524	666	823	868	920	661
Cattle	324	329	369	518	552	561	581	621	588	714
Cocoa	197	144	92	143	82	135	76	146	124	74
Kava	Na	na	Na	na	na	242	250	262	494	346
Other Commercial agri	124	179	181	190	199	137	133	115	116	118
Subsistence Agricultur	1,182	1,159	1,186	1,214	1,266	1,304	1,309	1,315	1,320	1,325
Forestry & Logging	72	499	377	424	477	106	125	131	129	129
INDUSTRY	<b>1,757</b>	<b>1,902</b>	<b>1,742</b>	<b>1,763</b>	<b>1,892</b>	<b>1,691</b>	<b>1,489</b>	<b>1,220</b>	<b>1,328</b>	<b>1,427</b>
Manufacturing	871	1,002	930	864	899	670	675	568	587	587
Electricity	235	229	199	204	205	503	440	315	408	423
Construction	651	671	613	696	788	519	373	337	333	418
SERVICES	<b>7,435</b>	<b>8,426</b>	<b>8,612</b>	<b>8,878</b>	<b>9,030</b>	<b>9,277</b>	<b>9,344</b>	<b>9,537</b>	<b>9,825</b>	<b>9,727</b>
Wholesale & Retail Tr	3,138	4,061	4,182	4,180	4,198	4,256	4,357	4,501	4,838	4,838
Hotels & Restaurants	498	546	590	612	598	516	567	703	685	681
Transport/Storage/Co	857	890	907	951	953	1,404	1,318	1,229	1,237	1,206
Finance & Insurance	1,118	1,089	1,041	1,010	1,035	1,040	1,023	1,031	1,024	1,038
Real Estate/Other servi	788	792	757	805	834	867	875	886	888	888
Government services	1,290	1,380	1,440	1,652	1,715	1,488	1,493	1,478	1,442	1,369
Less:Imputed banking	254	331	305	331	302	294	289	291	289	294
GDP (producers prices)	<b>11,758</b>	<b>13,183</b>	<b>13,088</b>	<b>13,676</b>	<b>14,024</b>	<b>14,119</b>	<b>14,129</b>	<b>14,213</b>	<b>14,843</b>	<b>14,522</b>
Growth Rate (in % )	4.8	4.7	-0.7	4.5	2.5	3.2	0.1	0.6	4.4	-2.2
Population	154320	158065	161901	165829	169853	173975	178196	182520	195021	200891
GDP per capita (US\$)	586	642	622	634	635	624	610	599	585	556

(About VT130 = US\$1)

r: revised

p: provisional

Source: Statistics Office, Statistical Indicator, First Quarter 2000 and Provisional Estimates provided by Statistics Office, Port Vila, Vanuatu

The CRP document states that “Government’s overall financial balance<sup>18</sup> has been in deficit in every year since 1989 (as shown in Table 7 below). As a result, public debt has increased over this period at an annual rate of 12% and now (1997) stands at 22% of GDP. The Government has been almost totally dependent on aid flows to finance development, but current levels of aid cannot be relied on in the future.” Further Government supplementary budget allocations were done without due consideration to equal revenue raising. In 1997 several supplementary budget allocations were effected resulting in cash flow crisis in mid-1997. Annual budget submissions continue to increase annually and Government must take immediate action in prudent fiscal management and consider alternative ways of raising equal revenues to match expenditure increases.

**Table 8: Summary of Revenue and Expenditure By Year (in millions of Vatu)**

Year	Tax Revenue	Non-Tax Revenue	Cash Grants	Total Revenue	Total Expenditure	Surplus or Deficit	Financing
1989	3,364	789	1,338	5,491	6,750	-1,259	1,237
1990	3,981	913	486	5,380	6,826	-1,447	1,506
1991	3,678	960	588	5,226	6,471	-1,245	1,590
1992	3,953	1,037	451	5,442	6,043	-601	185
1993	3,922	1,033	369	5,324	6,266	-942	459
1994	5,007	863	277	6,147	6,539	-391	307
1995	5,002	1,184	777	6,963	7,661	-698	577
1996	5,421	929	477	6,827	7,283	-455	277
1997	5,719	490	653	6,861	7,022	-160	161
1998	5,933	748	371	7,052	10,111	-3,059	3,057
1999	5,925	828	525	7,278	7,652	-375	375

(About 130 Vatu = US\$1)

Statistics Office, Statistical Indicator, First Quarter 2000

## **2.2 Sectoral Contributions**

The value added of the agricultural sector remains buoyant throughout the 1990s so that in 1990 it was estimated (at 1983 constant prices) to be 22% of real GDP and in 1999, it was 23%. This slow change reflects little diversification in the sector and the continual reliance on a narrow range of export commodities. Subsistence agriculture supports about 79% (1999) of the population but contributes only between 8% to 10% to real GDP in the 1990s as shown in the above table. Whilst in 1990 the subsistence value was 10%, in 1999 it represents some 9% of real GDP share. Whilst this slight decline trend is interesting it might show some signs of gradual move away from the traditional subsistence sector to the society’s want of a modernized sector. Cattle production has consistently increase as shown in Table 6. Kava production has also performed well and extremely well in 1998 (an increase of 88.7%) so that in 1999 saw a decline by 30.0%, however, it was still an increase compared to the 1995 available figures. Copra’s contribution although stagnant, remains the country’s main cash crop accounting for 4.6% GDP (1999). Other commercial agriculture is expected to continue to grow when niche markets are explored and developed fully; and forestry although declined from its peak (3.4% of GDP) in 1994 is forecasted for positive growth when outstanding land disputes are settled.

<sup>18</sup> ‘Overall financial balance’ is the difference between (1) recurrent revenue (taxes, dividends, rents, etc) asset sales and aid grants and (2) recurrent and development expenditure. A negative balance reflects a ‘deficit’ prompting Government to either use reserves (if any) or borrow to finance the balance.

The fishing industry is relatively small and catered mainly for the local market. Its contribution is included in the 'Other Commercial agriculture' in Table 6 which amounts to around 0.8% to 1% of GDP; and the tourism sector offers prospects for growth in fisheries. Recent establishment of foreign investment in the fishing industry and a proposed cannery should boost growth during this decade.

The industry sector being the fastest growing sector contributing between 12% to 15% of GDP throughout the 1990s is principally led by rapid and consistent growth in manufacturing. Its share is expected to increase dramatically during the next decade when major pipelined projects are implemented.

The services sector, by far, is the dominant sector with its GDP contribution amounting to around 60% to 70%. During the decade it grew at a rate of 3.0% per annum. This largest component of the economy presents interesting features. About half of this sector comprised the wholesale and retail trade with its value added varying between 26% and 34% of GDP. Its contribution has been on a consistent real increase throughout the decade while that of the hotels and restaurants (representing largely the tourism sector) fluctuated reflecting the vulnerability of this sub-sector to natural disasters, adverse publicity<sup>19</sup>, airline reliability<sup>20</sup> and weather conditions.

The tourism sector is estimated to have provided the country with VT890 million (or US\$6.8 million) in the form of tax schemes and generated formal employment to some 7,000 full-time people in 1999. Tourist expenditure amounts to VT8.3 billion (or US\$63.8 million) representing some 28% of nominal GDP and accounts for more than half of export earnings. Attached as Annex Four is an information table on tourism.

Finance and insurance which incorporates the Offshore Finance Centre accounts for some 7 to 10 percent of GDP. Its real performance appears stagnant through out the 1990s which might be due to OFC's difficulty in competing with other attractive tax havens and its insufficient marketing allocations prohibiting aggressive counter marketing. Real estate and other services maintain its consistent real growth which reflects substantial increases in house rents mainly in Port Vila. Government's share has increased from 11 percent to 12 percent in 1990, but declined in 1995 in real terms and continued to decline consistently thereafter.

### Women Development Issues

Vanuatu recognized women issues as central to development of the country as reflected in consecutive national development plans. However, women's contribution to the economy continues to be under-valued, they are under-represented in Government decision-making bodies (currently no woman parliamentarian), economically dependent on men and economic inequality exists, prevalence of violence against women, women's mental health is adversely affected as a result of overworked domestic and subsistence responsibilities, etc. The Vanuatu Third Development Plan states "*lack of policy and planning guidelines to provide direction to the allocation of resources to effectively address women's social, political and economic needs. The under-representation of women in planning and decision making means*

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<sup>19</sup> Civil Servants strike for higher wages in 1994; VNPF riot in 1997 for alleged misappropriation of members funds by politicians; a US\$100 million scam; sale of Vanuatu passports, misappropriation of cyclone funds, maladministration of development bank, etc.

<sup>20</sup> Air Vanuatu, Vanuatu's only international airline was struck by a hailstorm and took almost four months for it to be repaired. The airline has only one Boeing 737 aircraft.



*that the real needs of women are rarely acknowledged.*” The CRP identified the benchmarks of the situation of women in Vanuatu is attached as Annex 3. A matrix shown under Annex 2 provides information on Vanuatu’s plans of action to addressing issues raised in international women conferences (e.g the 1995 Beijing World Conference on Women, UNGASS Women 2000, Gender Equality, Development and Peace in the 21<sup>st</sup> Century, etc) with efforts to eliminate all forms of discrimination against women.

### External Trade

Vanuatu is party to a number of preferential trade agreements with other countries viz.

- SPARTECA – provides reduced duties for exports entering Australia and New Zealand;
- LOME IV – applies to exports to the European Union countries; and
- GSP – applies to exports to the United States;
- MSG Trade Agreement – applies to exports to neighboring Melanesian countries of the Pacific, viz. Fiji, Papua New Guinea and Solomon Islands.

Vanuatu actively participates in advocating a Pacific Free Trade Area (PFTA) for the Pacific island nations and generally there has been a move by these countries to significantly reduce tariffs. The proposed establishment of the PFTA, would exclude initially neighbouring Australia and New Zealand, is strongly advocated by the regional umbrella organization of the South Pacific Forum Secretariat. While the economic gains by smaller countries, especially those which export little merchandise, may be low in aggregate, the move is providing the extra stimulus for those countries who have yet to join WTO.

Vanuatu as part of the Melanesian Spearhead Group (MSG) ( others were Papua New Guinea, Solomon Islands and Fiji who joined few years later) entered into an agreement in September 1994 allowing duty free access for the export of beef from Vanuatu, canned tuna from the Solomon Islands and tea from Papua New Guinea. The following year the agreement was amended to include other items and to allow the list of items to originate from any MSG country. Prior to the agreement there had been little trade between these countries but the agreement saw greater ties being established between these neighbor Melanesian economies.

In May 1995, Vanuatu submitted a formal application for accession to the World Trade Organization (WTO), which to date is still under consideration. Given Vanuatu’s status as an LDC the economy will have until 2010 to modify and adjust its trade regime before reaching agreement with WTO rules. The main requirement would be modification of the trade regime which Vanuatu is currently highly dependent on for the provision of Government revenues. Influential members of WTO have also highlighted additional conditions for Vanuatu to consider before they can render their support for Vanuatu’s accession. These conditions would require significant restructuring input of Vanuatu’s taxation system and allow Government’s trade operations to be transparent and be accessible to by WTO. This will effectively require the economy to be subjected to a more competitive global trading environment which should create development opportunities in the longer term. Any future reductions in taxes should be on the basis of a detailed study.

### Development Plans and Programmes

Since independence in 1980 Vanuatu had embarked on national development planning. The results of the plans were mixed. Under Third and Fourth (unpublished) Development Plans problems associated with the plans were identified. The most obvious was the lack of ownership and community participation in the planning process. Sustainable development

can be achieved if the intended beneficiaries participated in all aspects of needs identification, project/programme design, implementation and maintaining the programmes thereafter donors support has been withdrawn. It was recognized that the exclusion of the budget process from the planning function also impacted on expected deliverables of the planning process. The lack of political will and implementation capacity contributed towards the mixed result. Too ambitious plans and not focussing on key developmental issues and ensuring timely publication of these plans are also factors that determine the success of those plans.

Vanuatu has now moved away from that form of planning to strategic planning following reforms proposed by ADB. This has implications for the former National Planning Office which has now changed to Department of Economics and Social Development (DESD). The drive towards decentralization entails moving the sectoral planning functions of the former National Planning Office into the operational departments where the expertise will be essential to the perfection of departmental plans and budgets in the output budgeting exercise. It is hoped that the control component of the National Planning Office will be absorbed naturally into the Ministry of Finance where DESD is now located.

#### Comprehensive Reform Programme (CRP)

In the face of continuing economic stagnation, poor social services, increasingly unstable government, inefficient public administration and the abuse of power, the CRP was introduced. *“This has given rise to a crisis of confidence in government, irrespective of which parties are in power. Most countries are forced onto the path of reform by a fiscal crisis. While such a crisis is certainly looming in Vanuatu, it is this crisis of confidence in government which has triggered the present desire for reform. The need for reform is given added urgency by the changing global situation. Vanuatu cannot insulate itself from the tendency towards global markets, international competitiveness and shrinking protectionism”* (CRP: 1997. p.8).

The government accepted the ADB proposal for reform and embarked on a nation-wide consultation process. The reform wanted to renew institutions of governance, redefine the role of the public sector, improve public sector efficiency, promote private sector-led<sup>21</sup> growth and improve equity. The CRP was accepted by Vanuatu through a National Summit which included a spectrum of all people in the society including Government Ministers, politicians, senior civil servants, private sector, NGOs, farmers, Chiefs, Churches, Women representatives, youths, technical assistants, etc.

The vision statement of the CRP is accepted as the national vision and incorporates elements of national cohesion, a well governed, democratic nation, economic prosperity, the empowerment of individuals, families and communities, a well educated population, an improved and accessible system of health care, improved national infrastructure, an erosion of prevailing disparities between islands and rural and urban areas, the retention of traditional values and culture, and the preservation of the country’s physical environment.

The CRP Action Matrix is adopted as part of the Programme of Action (2001-2010) and is attached as Annex Five.

#### Structural Adjustment Programme

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<sup>21</sup> Private sector as used in the CRP includes small businesses, farmers, NGOs....every one outside the public sector

Vanuatu has applied for a Structural Adjustment Support Programme from the European Union and is currently preparing the final documents to necessitate the draw-down. It is expected that the fund would go towards fiscal consolidation.

## **CHAPTER THREE: ASSESSMENT OF CONTRIBUTORY FACTORS TOWARDS COUNTRY'S DEVELOPMENT**

In order to understand clearly the factors that either facilitated or constrained the country's development, it is important to isolate domestic factors from external ones. This distinction is necessary to facilitate the preparation of the Programme of Action.

### **Domestic Opportunities and Constraints**

#### **3.2 Peace and Social Stability**

Political stability is a necessity for continuous economic growth and social progress. In the 1980s the political environment was relatively stable, based on one party system, but has not been maintained likewise and was increasingly volatile during the 1990s when coalition governments formed. The situation worsened during 1996 when three different governments were formed and a major reshuffle occurred. Political change brings about discontinuity and lacks application of governance principles. Usually, when governments change, outgoing governments do not permit incoming governments access to their files thereby disallowing Government employees from pursuing policy initiatives created by earlier governments.

As governments desire to involve themselves in the day-to-day operations of Government and public sector entities, political appointments (often professionally unqualified) were made. These appointments were based on individual's political affiliation and narrow political considerations and not on qualification and experience based. ADB stated in its report, 'Vanuatu Economic Performance, Policy and Reform Issues' that their major conclusion "*is that political reform is the single most important requirement for Vanuatu to achieve improved social and economic performance*".

A civil servant strike for better wages in 1994 lasted more than twelve months affected the delivery of services. The dismissal by Government of those on strike and the appointment of replacements not on the basis of merit continued during the 1990s which adversely impacted on the capability of Government institutions to deliver to the expectation of the people.

Knowledge of bad governance during the 1990s was widespread. The publication by the Vanuatu Ombudsman on the '*Public Report on the Vanuatu National Provident Fund, Housing Loan Scheme*' revealed maladministration of the VNPF and abuse of member's funds by the General Manager and the Board of Directors, politicians and political friends which prompted members to stage a major riot which ransacked and looted several retail shops, a meat factory, construction company, a garage and rampaged the VNPF building. Estimates of the costs of damage ran into millions of dollars. Government's approval of a 'payout' of member's contributions affected the monetary system and gave boost to increase in domestic lending interest rates. The Reserve Bank of Vanuatu imposed necessary measures to 'mob up' the excess liquidity to stabilize the financial situation of the country. The increased interest rate has now stabilized but remains very high to stimulate domestic borrowing.

#### **3.3 Economic Infrastructure**

The widely dispersed nature of the country makes it almost impossible for Government to provide adequate economic infrastructure to facilitate development growth. The domestic

shipping industry has been protected only for locals throughout the 1990s until the enactment of the new Vanuatu Foreign Investment Board Act in 1999 opening the sector for foreign investment. Limited shipping services lack cooling storage facilities. Wharves, which were subject to poor design and construction faults, constructed under a project loan from ADB had not received maintenance and deteriorated rapidly after cyclone devastation. Lack of regular maintenance of existing infrastructure is a significant impediment to economic development as revealed by the ADB funded PPTA<sup>22</sup> study.

Throughout the 1990s it is apparent that Government placed priority on construction of new national roads, bridges and feeder roads to the neglect of the establishment of timely maintenance programs, thus expected benefits were not sustained for long-term. The recent PPTA with broad objectives to identify and formulate infrastructure projects that would assist generate economic activities in rural areas is still under feasibility stage. The project is expected to identify key projects for loan funding from ADB. The final project is designed to increase producer surplus from increased production and higher farm prices with associated reduced freight costs and increased personal mobility.

Presently the country has only two ports, in Port Vila and Luganville, where port facilities exist. Most recently, four places were announced international port of calls additional to two existing ones. These new ports are, Anelgwahat (on Aneityum, Tafea), Litslits (on Malekula, Malampa), Loltong (on Pentecost, Penama) and Sola (on Vanua Lava, Torba) but these ports have yet to be developed and equipped with international stevedoring facilities. None of these new ports possess wharf and stevedoring facilities for international shipping. These developments if facilitated could generate positive impacts of cost reductions on imported items and balance the existing price differentials between urban and rural areas.

The country has only one fully developed international airport (Bauerfield) with accommodation capacity of Boeing 737 aircrafts. Construction has commenced for upgrading of the existing airport on Luganville to accept Boeing 737s. Domestic air transportation is provided by Vanair<sup>23</sup> through 25 domestic airports. Many domestic airports are badly in need of maintenance and repair, and loss of asset would result if no immediate action is taken to reconstruct and maintain the assets which are 100% Government-owned. Pipelined projects to rehabilitate and tar-seal four domestic significant airports, Longana (on Ambae, Penama), Norsup (on Malekula, Malampa), Lonorore (on Pentecost, Penama) and Craig-Cove (on Ambrym, Malampa) has commenced. This upgrade should enable the airports to be serviceable even through rain conditions. With existing grass surface it is difficult to land and take-off during rainy seasons.

Only urban centers are provided with regular supply of electricity and piped water system and have easy access to telecommunication systems. Much of the rural population lacks these utilities. Whilst rural telephone systems are available they are not evenly spread to enable easier access. Most of the rural population obtain water through rivers, wells and water tanks. In compliance with the CRP's broad reform agenda of redefining the role of the public sector, improve public sector efficiency and allow for private sector-led growth. The utility sector (water, telecommunication and power) should be examined consistent with its regulatory regime as part of the process of improving performance and consider reducing the high costs associated with the operation of public services.

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<sup>22</sup> PPTA stands for Project Preparatory Technical Assistance

<sup>23</sup> Vanair is the domestic airline with 100% Government shareholding

### 3.4 Policy Reforms

In 1997, through ADB's financial support Vanuatu introduced a comprehensive reform programme with broad objectives to renew the institutions of governance, redefine the role of the public sector, improve public sector efficiency, improve equity between sections of the population and engage the economy to be led by the private sector, including the rural and small business sectors. The reform programme, which received overwhelming support from donor partners, was introduced as a result of continuing economic stagnation, poor social services, increasingly stable government, inefficient public administration and the abuse of power. Additionally these reforms were instituted to enable Vanuatu pursue compatibility with global trends in international competitiveness, freer trade and deregulation and shrinking protectionism. Special features of the Vanuatu's reform is to have a common destiny and vision for all people, which was lacking. The reform embraces a desire for national cohesion and a well-governed and truly democratic nation.

Three years lapsed since the introduction of CRP. While it is too early to draw conclusions on the successes and failures of the programme, it is generally accepted that some positive progress has been achieved. Given the three years of reform, there is mixed feelings about the results. There is continuous widespread criticism of the expected deliverables by, particularly, the Government sector. The CRP appears to have little positive impact on health and education services delivery. While it is accepted that the benefits of reform do not surface until many years, it remains to be seen whether redefining the role of the public sector, right sizing the public service, recruiting qualified and experienced personnel and placing them in appropriate positions, reform awareness programmes, elimination of political interference, etc. will bring about improvement in the delivery of services. Criticism has also been leveled at the lack of road maintenance in both rural and urban areas. Implementation of pipelined infrastructure development projects were delayed as a result of poor design, management and political interference.

Whilst there is general improvement in provision of Government services, the reduction in employment size of the public service has impacted adversely on provision of some services. It is claimed that the Public Service Commission, which is expected to develop a service-oriented culture, is unable to deliver because of its limited skilled manpower resources. Its inability to respond promptly and positively recommendations put to it by Government is impacting on the delivery of services.

Past weaknesses in financial management was said to have contributed to inefficient and wasteful expenditures, inability to collect all debts owed to Government, tax structure and collection system which yielded a declining share of GDP and unwise investment decisions resulting in substantial losses in public enterprises. The Government must design a sustainable collection system of outstanding revenues and monies owed to Government by private individuals and businesses which to date is valued at about VT300 million (or US\$2.4 million).

The Finance Ministry has undergone considerable review and is now supported by mostly Australia's financed technical assistance. The introduction of program budgeting under CRP encourages public servants to focus on the provision of services, as opposed to drawing of salaries and spending available budgets. ADB said, this would also enhance transparency to the extent that the cost of various government programs are actually clarified. Under the CRP, the new Public Finance and Economic Management Act was enacted by Parliament in 1999 to enable provide a set of transparent standards against which the Government's

performance can be judged, new policies and systems and financial regulations were established. These frameworks are established to ensure greater transparency and accountability, responsible fiscal management, more efficient tax structure, prudent level of public debt, an integrated framework for strategic planning, budgeting, programme implementation, monitoring and financial reporting and define clearly the roles of Parliament, Council of Ministers and the Minister of Finance in terms of authorisation of expenditures, borrowing and granting of guarantees.

The lack of skilled human resource inevitably demanded the use of foreign advisers in implementing the reform programme and various operational Government activities. In October 1998, 42 consultants were directly advising on one programme i.e CRP related activities. Ni-Vanuatu officials of four major sectors of Government raised concerns regarding the performance of some technical assistance and the need for local control and ownership of the reform processes. Such concerns could undermine sustainability of the CRP and self-reliance. The CRP has rightly emphasised the need for national capacity building and development and implementation of a human resource development plan.

The output of CRP is an expectation of an improved governance. Enactment of new legislation including, the Government Act, Public Finance and Economic Management Act, Expenditure Review and Audit Act, the Public Service Act, Leadership Code Act and the Ombudsman's Act will ensure measures of accountability, transparency and predictability of government actions are guaranteed. Increased participation of the wider community, particularly non-government stakeholders, in the business of government is encouraged through these legislations.

### 3.5 Conducive Environment for Private Sector Development

The following are key elements for a conducive environment for private sector development:

- Stable macroeconomic regime (to avoid periodic crises of adjustment);
- A trade and tax regime that facilitate business entries on internationally competitive terms and does not discriminate against firms and sectors;
- Clear, enforceable property rights and non-discriminatory regulatory environment to ensure agreements and choices can be made and respected;
- A competitive and adequately skilled labor force; and
- Adequate and well maintained physical infrastructure.

Lack of access to capital remain the major obstacle for locals to enter into any domestic business. Although land (a possible collateral for borrowing) is available the customary ownership structure and the institutional structure of land effectively prevents private sector development. The process to lease land is long, cumbersome and problematic which requires immediate review and attention. The absence of an institutional structure with authority to act promptly on issues of land disputes must be addressed as a matter of urgency. Additionally political instability during most of the 1990s is a major contributor in loss of investors' confidence. It remain difficult for investors to risk their capital and resources in a country where they are unable to predict the outcome of Government policies. This unstable political environment is a major bottleneck in advancing private sector development.

One of the most outstanding reform measures in the past decade has been in economic liberalization and promotion of the private sector. The lack of transparent policy direction and foreign investment hampered private sector development. Although foreign investment is

recognized as an element for economic growth, Vanuatu, like other LDCs, has not progressed positively towards attracting any new real major investment. A lack of clear foreign investment policy designed to promote investment in Vanuatu appears to constrain further progress during the 1990s and remain today a concern for the VFIB. Vanuatu should consider further streamlining the bureaucratic and administrative processes in place to facilitate both private domestic and foreign investment. Only three years ago the Vanuatu Foreign Investment Board Act was enacted by Parliament providing as a ‘one stop shop’ the direction and facilitation for foreign investment. In 1999 saw some amendments made to the said Act enabling foreign investment competition in sectors previously restricted only for nationals.

Generally the cost of business establishment and maintenance are excessively high. Transportation costs by air, sea and road is extremely costly and development of a reliable transportation network must be undertaken. Utility costs of water, electricity and telecommunication are comparatively some of the highest in the Pacific. Production of labor-intensive commodities are restricted due to the relatively high cost of labor. There is an absence of skilled labor in the area of managerial, technical and entrepreneurial skills. The high cost of labor is driven by the sizeable highly paid expatriate labor, taxation system lenient on trade taxes on consumption as the main source of Government’s revenue, shortage of skilled labor and high subsistence wage. The intention to maintain the tax haven status and the Offshore Financial Centre has led to the over-reliance on trade taxation as the major source of revenue raising for Government. This narrow tax base has impacted in a high cost environment and encourages import substitution and discourages exports. It is a widely held view that outward looking export-led private sector achieves successful and higher economic performance and growth.

In Jegathesan’s<sup>24</sup> report for UNCTAD and Government he states *“Thus an immediate challenge facing Vanuatu if it hopes to become an attractive investment environment is to examine urgently this factor of costs and how these can be reduced to a competitive level. Where such costs cannot be reduced, then the investment environment should become so efficient and productive that the cost factor becomes a secondary issue in the calculations of foreign investments.”*

### 3.6 Human Resources Constraint and Population Growth

Vanuatu had a remarkably low level of human resource and was ill-equipped with required skilled labor force to support strong economic growth when independence was granted in 1980. Since that period, Vanuatu recognized the lack of an educated, skilled, literate, numerate labor force as one of the greatest obstacles to business development and has equally placed human resource development top of its priority agenda. It equally recognized that sustainable economic development and alleviation of poverty is easier achieved with an appropriate skilled and healthy population. These attributes are also essential elements for economic growth. The lack of skilled human resource is evident across all sectors of the economy and is particularly so in specialized areas of technical, managerial and entrepreneurial skills.

Through out most of the 1990s, the public service was operated by personnel not appropriately qualified. It is for this reason that some 36% of total external aid goes towards funding technical assistance designed to transfer foreign expertise and train national capacity.

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<sup>24</sup> Mr J Jegathesan was commissioned by UNCTAD to prepare a paper on “Strategic Development for Economic Recovery” for Vanuatu.



Central to the CRP's objectives is national capacity building and institutional strengthening through the human resource development plan. As achieving national capacity and increasing human capital is a long term objective, it remains to be seen whether the expected result of institutional and capacity strength is achievable within defined term. However, education and skill development are investments that require many years of national effort on a large scale to generate any real significant economic benefit.

Vanuatu's population growth at 3.0% adversely affects efforts to alleviate poverty and to sustain human resource development in as far as it constrains the allocation of sufficient resources for social spending. It is widely accepted that "*a slowing of rapid population growth is likely to be advantageous for economic development, health, food availability, housing, poverty, the environment, and possibly education, especially in poor agrarian societies facing pressure on land and resources*" (Alburg, et.al., 1976). Recently Vanuatu adopted its first ever National Population Policy designed to contribute to a sustained rise in the real standard of living and the quality of the life of the population. The Policy is designed to ensure that the future size and structure of the population are compatible with the vision statement of the Comprehensive Reform Programme which incorporates elements of national cohesion, a well governed, democratic nation, economic prosperity, the empowerment of individuals, families and communities, a well educated population, an improved and accessible system of health care, improved national infrastructure, an erosion of prevailing disparities between islands and rural and urban areas, the retention of traditional values and culture, and the preservation of the country's physical environment. The Population Policy also upholds the principles of the ICPD Programme of Action which was endorsed by Vanuatu. The 3% population growth is unsustainable and the country should seek to maintain a rate of population growth that is consistent with the national resource base and the country's social and economic potential.

While Vanuatu has registered progress in the past decade in human development standards, it recognized that it has a long way to go in terms of improving its human development standards. In UNDP's 1992 *Human Development Report* Vanuatu ranked 93<sup>rd</sup> out of 160 economies observed when composite index measure of life expectancy, literacy and real income is used. In the 1999 Pacific Human Development Report prepared by UNDP, Vanuatu ranked 3<sup>rd</sup> to the last, in terms of Human Poverty Index followed by Solomon Islands and Papua New Guinea.

### 3.7 Savings and Investment

Domestic savings remain low and erratic during the 1990s reflecting the low income and the limited engagement of the 79% of the population in the formal sector. However it is noteworthy to acknowledge dramatic increases, in 1990s from 1980s, in the level of domestic savings which suggests a substantial resource mobilization effort. Despite this increase the domestic savings are inadequate to finance investment. Like many island economies of the Pacific there exists a large resource gap between domestic savings and investment and for Vanuatu is estimated to be around 25% of GDP. This gap is being filled by official transfers or official development assistance which is estimated to be around 28% of GDP. The sizable transfer payments reflect the relatively large volume of foreign aid received by Vanuatu although this has declined substantially since independence.

Real interest rates on bank deposits have been low. People usually use their bank deposits as securities for small borrowings. There is a tendency for people to borrow and spend once incomes have been generated, thus savings may be insensitive to interest rates.

**Table 9: Percentage Growth in money and prices, and interest rates**

Year	<i>Annual growth</i>			<i>Real interest rates</i>		
	Net Foreign assets	Domestic credit	Total liquidity	Consumer prices	3-6 months deposits	Personal loans
1991	22.4	4.5	25.2	5.6	0.7	6.4
1992	-7.0	36.8	-2.1	5.1	-0.5	6.9
1993	10.3	4.5	10.6	1.7	3.8	10.3
1994	-6.1	14.3	4.7	2.7	1.8	9.3
1995	15.4	12.9	11.6	1.7	3.6	11.9
1996	7.3	12.6	10.1	-0.1	5.4	12.1
1997	-1.4	-1.1	-0.3	5.1	-0.7	6.9
1998	12.7	22.2	12.6	4.1	0.0	8.7
1999	-18.6	11.1	-9.2	0.0	3.7	12.6

Source: Reserve Bank of Vanuatu, Quarterly Economic Review, Port Vila

While domestic investment increased during the 1990s, the productivity of this investment has so far been disappointing. Infrastructure has been the major component of priority for Government's development budget in the past decade. Most of these developments have been financed by external aid with a small Vanuatu Government contribution. However, a major pipelined project to developing new and maintaining existing infrastructure on outer islands is currently being pursued. Vanuatu may resort to loan funding if cash grants by donors are unobtainable.

The National Provident Fund is a compulsory saving scheme for workers aged between 14 and 55. This fund has been established to assist workers and their family after they have retired, permanently disabled or at the time of death a family benefits. This compulsory saving scheme is important as the country does not have a government-funded social welfare system designed to assist workers who are not in employment.

### 3.8 Women in Development

Three consecutive National Development Plans prepared by the state acknowledged the role and the contribution of women in national development. This acknowledgement was in the form of establishing the Department of Women's Affairs under the Prime Minister's portfolio, a Vanuatu National Council of Women, Province, Island and Area Councils of Women network during the 1990s. These developments are further supported by the CRP which states "*Women feel that their contribution to the economy is under-valued, and consequently there is too little attention paid to their special needs with regard to health care, education, etc. They also feel excluded from the highest levels of decision-making... This absence of one gender from positions of power is often said to be culturally determined. But culture is not static. Societies advance by selecting and perpetuating positive, humane aspects of their culture while leaving behind discriminatory and constraining elements*".

It is recognized that the lack of clear policy guideline constrained the allocation of resources to effectively address women's social, political and economic needs. Inadequate institutional support and the lack of sufficient budgetary support constrained the capacity to provide coordination, policy and planning advice to organizations pursuing women's interests. Absence of inter-sectoral cooperation and coordination system to facilitate effective resource

allocation and ensure implementation of women programmes also contributed to the unbalance treatment of women. Women's development is further constrained by prevailing customs and cultural aspects of the male attitude that women's place is in the home, and their contribution is secondary. This effectively discourages support from spouses. Ni-Vanuatu women have very heavy workload involving child care, domestic work and food production. Women also participate in cash-economy. Because of their workload and their expected average 5-6 children deliveries their health deteriorates more rapidly.

Only in 1999, an inter-sectoral Population Policy was formulated. In that policy statement, Vanuatu accepts that population-related goals and policies are integral parts of cultural, economic and social development. The principal aim of this is to improve the quality of life of all ni-Vanuatu people. This policy confirms that human rights of women and the girl child are inalienable, integral and indivisible part of universal human rights and will aim to advance gender equality and equity, the elimination of all kinds of violence against women, and ensure individual women's ability to control their own fertility.

Nine benchmarks identified in the CRP of the situation of women in Vanuatu is attached as Annex 4. CRP further included in its Action Matrix the following policies and actions:

- *“Incorporation of gender awareness and gender analysis into policy-making at all levels;*
- *Introduction of a strong gender dimension into the collection and analysis of statistics;*
- *Review of all legislation to ensure gender neutrality;*
- *Incorporation of gender awareness education into Government and donor-sponsored community activities on natural resource management and human resource development, and at the Government Training Centre;*
- *Development of policy and legislation on violence against women and children – including rape, incest, domestic assault and sexual harassment. (in theory violence is a gender-neutral issue, but in practice some kinds of violence are disproportionately directed at women);*
- *Creation of a working group to coordinate and monitor the above;*
- *Appointment of a Planner with specific responsibility for gender policies and programmes;*
- *Adoption of nine benchmarks (see Annex 4) for periodic reviews of progress towards gender equity.*

A Matrix containing international programmes on women and recommendations with corresponding national actions is attached as Annex 2.

### 3.9 Agriculture and the Rural Sector

Agriculture is the mainstay of Vanuatu's economy and is bound to remain dominant for the foreseeable future providing along with forestry and fisheries the best opportunities for broadly based growth and employment. It provides the subsistence livelihood for 79% of the population. Its contribution to real GDP has declined during 1992 and 1999, attributable to weak commodity prices, impact of cyclones and changes in the general weather pattern and the gradual diversification of the economy. Overall, the agricultural contribution has declined from an estimated 29% in the 1980s to some 23% in 1999. The value of merchandize exports in 1999 is estimated to be around VT2.9 billion reflecting a decline from 1997 levels. The effective performance of this sector is also determined by external factors, such as the terms of trade and weather (cyclones, etc) conditions. Vanuatu experiences about 1-3 cyclones per year that are often destructive to amongst others, agriculture. The impact of cyclones on the economy is often severe as tourism declines in the

aftermath of a cyclone while food shortages develop in mainly rural areas. Women and children are often the hardest hit.

The agriculture sector is dominated by subsistence agriculture which accounts for about 45% of the sector's value added. Many experts believe the subsistence sector is grossly undervalued, but statistics relating to agriculture are limited. It is widely accepted that real poverty does not exist in Vanuatu. Every one has access to housing, food and water. Results from the 1983/84 Agricultural Census shows that rural subsistent farmers have the capacity to produce more using existing labor-intensive methods but the lack of markets prohibits such development. Compounded with this constraint are physical constraints of custom land ownership which disable land lease/ownership transfer to enable taking advantage of economies of scale, specialization and market exchange. Difficulties associated with land leases/ownership transfer also constrained borrowing for large-scale agricultural investment. This constraint also offers difficulties for foreign investment in the sector.

Constraints affecting the agricultural sector are common to all other economic sectors. Difficulties experienced in accessing credit, high labor costs with corresponding low productivity, high transport costs (inclusive of shipping) network for farm to market transportation, limited infrastructure, including airfreight capacity to take advantage of off-season market opportunities, to facilitate marketing and the lack of suitable storage facilities, high costs of energy, water, power and telecommunications have all played a part in constraining increased agricultural production and commercializing the subsistent and rural sector of the economy where the majority (79%) of the population resides.

Often new initiatives introduced by the Government's Ministry of Agriculture, Livestock, Forestry and Fisheries failed, although many of these initiatives were heavily subsidized by Government. This reflect farmers attitude towards the risks involved in adopting new improved methods and the expected return on their labor and investment.

With technical assistance provided by UNCTAD<sup>25</sup>, Vanuatu is pursuing the finalization of a Strategic Development for Economic Recovery based largely on agriculture. In that unfinalised report foreign investment in the following agricultural areas were identified and proposed:

- *“Vanuatu offers potential for beef production and exports. The department of Veterinary confirmed 1300 tons of beef are exported every year, primarily frozen meat and also jerky. 50% of cattle is from small holders. There is potential for recovery of offal (liver/heart) which currently being discarded. There is potential in tannery. At present hides are exported to as ‘salted-blue’ to New Zealand. Vanuatu’s beef is free of diseases and is virtually of higher quality than even Australia and New Zealand beef.*
- *Fishing offers great potential not only within the 6 miles national water limit but for deep sea fishing (12-200 miles EEZ). However there were differences of opinion on the availability of fish. The Department of Fisheries has however developed an Atlas of Fish Availability. The urgent need is also for facilities in the diverse islands for freezing of fish, storage facilities and ships, to collect and transport fish to a central location. These measures would help local fishermen in the various islands.*
- *Forestry offers potential. At present basically sawn timber is exported. There is potential for planting of the timber (Forest Plantation), production of furniture for exports, etc.*

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<sup>25</sup> UNCTAD report prepared by Dato J Jegathesan, UNCTAD Consultant for the Vanuatu Foreign Investment Board and the Vanuatu Government. Report has not yet received Council of Ministers approval.

*Concession areas for integrated timber processing is possible, but the problem would be to negotiate with traditional land owners for the timber areas. The Forestry Department could help in the negotiation to obtain lease. However, this would be lengthy and uncertain process.*

- *There is potential for various agriculture production of fruits, vegetables, etc. as the soil is very fertile. A land use map is available, but the problem again would be the traditional land owners to agree for substantial areas of land to be released for plantation purposes.*
- *Copra is a major export commodity from the abundance of coconut trees in Vanuatu. In 1999, VT1,384 million (US\$10.2 million) was received in foreign exchange earnings from exports of copra. The down-stream processing of copra into coconut oil (cooking oil) and other related products is a potential.*
- *Vanuatu is a natural producer of various exotic nut that could have increasing export market potential. However, there appear to be a complex of problems relating to motivation of villagers to collect nuts, transport facilities, etc. The possibility of plantation scale nut production should be examined.*
- *For both movement of goods (Vanuatu's natural resources, processed or unprocessed) and of people – the problem is shipping. This problem also offers an opportunity for development of shipping industry. Foreign investors should be invited into this sector. The problem of insufficient docking facilities at Port Vila for deep sea vessels is an issue. Only one ship can dock at any one time.*
- *There is potential for certain import substitution industries that would be transport sensitive for imports – e.g bulky products, building materials, etc”.*

An Export Development Strategy is being developed by the Department of Trade, Commerce and Industry to address the difficulties faced by farmers in exporting their products. In addition a detailed Sector Review of the Agriculture and Fisheries Sector funded by ADB was undertaken and proposals are being pursued by the Ministry of Agriculture.

### 3.10 Environment and Sustainable Development

In the drive towards economic growth and development, Vanuatu must ensure that this is achieved with minimal social costs (or negative environmental impact). Past three Development Plans saw environment feature strongly as a separate chapter of the document. DP3 states “*Although Vanuatu is a least developed country, the Government is committed to economic growth and development which has minimal negative environmental impact.*” The CRP also addressed the issue of the need to environmentally act responsibly now for the benefit of future generations. “*Now the environment is under threat in many ways. Accelerated development, if unregulated, could cause irreversible environmental damage.*” The CRP hopes to protect the environment through development of the following policy actions:

- *Full community participation in decisions about resource exploitation for development, having been informed about options and their environmental implications. (As has happened at Matantas, Santo).*
- *Creation of more national parks in the interests of preserving biodiversity.*
- *Clear definition of ownership of mineral resources, subterranean mass beyond the reefs and within the 200-mile Exclusive Economic Zone.*
- *Environmental legislation to plug gaps in existing laws – particularly covering waste management, water resources, dangerous substances, environmental impact assessment and biodiversity conservation.*

- *Establishment of the Environment Unit (with departmental status) permanently in an appropriate ministry in order to give it stability and so strengthen the government's efforts in the areas of environmental research, planning, legislation, regulation, public awareness and education".*

As part of the reform programme an environmental legislation has been drafted, an Urban Growth Management Strategy is being finalised, a Sanitation Master Plan is being formulated and a National Conservation Strategy established in 1993 to address the following ten conservation goals:

- Change the way we value natural resources
- Improve community understanding of environmental processes
- Improve community understanding of development options
- Improve Government's administration of the environment
- Ensure resources are used efficiently
- Ensure biological resources are used sustainably
- Improve land management
- Maintain water supplies
- Manage waste and hazardous materials
- Meet international environmental obligations

In 1994, Vanuatu endorsed the Suva Declaration on Sustainable Human Development in the Pacific to promote sustainable human development with the following broad goals:

- (1) Enhance the productivity of the rural and subsistence sector
- (2) Promote participatory and community-based development
- (3) Improve access to land
- (4) Expand employment and livelihood opportunities in the rural and subsistence sector
- (5) Address inequality and emerging poverty
- (6) Overcome disparities due to geographic locations
- (7) Promote the advancement of women
- (8) Ensure youth involvement and development
- (9) Support population policies and programmes
- (10) Support environmental re-generation
- (11) Promote preventative and primary health care
- (12) Ensure the relevance of formal and non-formal education
- (13) Establish effective governance
- (14) Finance human development

### 3.11 Governance

A major problem in Vanuatu which impedes economic growth and development, has been the governance of the public sector, particularly political interferences in the day-to-day operations of the public service. Other factors would be institutional failures and weak public administration, poverty and income inequality, low public sector remuneration and lack of formal incentive structures, and a weakening of those values and social practices contributed to accountability and transparency breakdowns. Unsound governance has impacted on the reduction of economic efficiency of the public service operations. The reform programme was introduced to enable greater accountability, participation, predictability and transparency in public sector operations. The reform, which also incorporated policies closely associated with structural adjustment aims to create a public sector which concentrate on 'core' functions, extends the operation market systems to the maximum extent possible, raises the

degree to which the economy is open to the rest of the world, and facilitates the globalisation process.

The donor community welcomes the CRP and the governance issues covered therein by providing funding assistance for programmes and projects designed to achieve improvement of public sector operations. While we wait to witness the benefits of governance reform, there must be a process of renewal and rebuilding of institutions<sup>26</sup> of Government. The institutions of Government are expected to provide wise responses to the many social and economic issues facing the country. Good fair and democratic government is an ingredient to economic growth and development and a promise for a prosperous nation.

To establish an effective basis for future good governance the following were proposed by the CRP:

- *“Strengthening Parliament’s role so that it makes better laws, provides an active forum for national debate and closely reviews the policies and activities of the Executive;*
- *The Council of Ministers, led by the Prime Minister, playing a key role in setting strategic directions for the future of Vanuatu;*
- *Enhancing the capacity, neutrality and independence of the Judiciary;*
- *Maintaining the separation of powers between the three main arms of Government as intended by the Constitution;*
- *Clarifying by law the roles of Ministers, their Political Advisers and the Public Service so that all work cohesively together;*
- *Providing for the staff of the Office of the President to be staffed by non-political appointees;*
- *Giving the Public Service stronger leadership that encourages a performance oriented culture, and a structure that better reflects national priorities;*
- *Strengthening the role and independence of the Public Service Commission in making public employment decisions;*
- *Ensuring through the Public Accounts Committee and the Office of the Auditor-General that there is accountability for performance.*
- *Reviewing the operation of the provincial and municipal government so that their efficiency is improved.”*

These proposals, many of which have already been implemented, were part of the CRP Matrix attached as part of this report. In 1999 a National Workshop, segmented into four components, was organized by the Honourable Speaker of Parliament for Member of Parliaments, senior women politicians, former politicians, Senior Civil Servants, Leaders of Civil Society Organizations and provincial women and men leaders. The objective of such a workshop was to raise and stimulate discussions on issues of governance, media and the consequences and magnitude of lost opportunity for economic growth in the event of accountability breakdowns and corruption. It is also aimed at identification and supporting best practices in promoting financial and political accountability and roles of media, parliament, watchdog institutions, the judiciary and civil society and develop national responses.

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<sup>26</sup> This includes a Parliament to make laws for the peace, order and good government of the country; a Council of Ministers to lead the Executive; a Public Service to advise on and implement policy; and a Judiciary to enforce the rule of law.

Legislations covering the Leadership Code and the Ombudsman's Act have been formulated and enacted by Parliament and are currently being implemented.

### 3.12 Industrialization and Technological Development

Industrialization could be an important strategy for LDCs to enhance their technological capability, diversify production in order to overcome the vulnerability inherent in their dependence on commodity production, and strengthen intersectoral linkages. Lack of the required specialized human resources and the industrialization and technological capability, Vanuatu would best not venture into such development strategy. Previous development plans have rightly not adopted this strategy. This attitude would remain unchanged for some time.

### 3.13 HIV/AIDS Control

While the issue of HIV/AIDS continue to pose real threat to many least developed countries, Vanuatu has not to date reported any cases of HIV nor AIDS according to the test results produced by the Health authority. In 1996 a sample of 1,504 people were tested for HIV of which none was identified positive. Because HIV testing among high risk behaviour groups has been limited, it is possible that HIV infections may already exist among the population. As a result of social changes, growing tourist industry, increasing numbers of nationals travelling abroad, urban-rural migration all suggest a high potential for HIV transmission. Increasing sexually transmitted diseases (Gonorrhoea, Syphilis, Trichomonas, Chlamydia, etc) can facilitate the spread of HIV/AIDS once the virus is introduced.

The STD/HIV/AIDS Prevention and Control Programme was developed in 1987 as Vanuatu's response to address the Global AIDS epidemic. Medium term plans were then developed and implemented successfully. AIDS/STD was introduced as a subject in schools curricula. In the 1990s a National Policy on HIV/AIDS was developed and is being used today. This policy will require immediate review to ensure its consistency with other national health policies and require legalizing. Bold decision should be taken in addressing the sensitive issue of testing potential high risk behaviours.

Existing programmes should be maintained and strengthened and continue to strengthen the promotion of SAFER SEX practices including use of condoms among the population who are involved with high risk behaviours.

## **External Opportunities and Constraints**

A supportive external environment inclusive of international support measures and the global trading environment is crucial for economic growth and development. In the recent trend of world globalisation, even with the best macroeconomic policies and national efforts it is unlikely that Vanuatu would be able to be successful in pursuing its development goals in the absence of favourable external factors.

### 3.14 Official Development Assistance

Much of Vanuatu's development is financed through assistance provided by bilateral<sup>27</sup> and multilateral<sup>28</sup> organizations. Aid flows dominate the transfers account and amounting

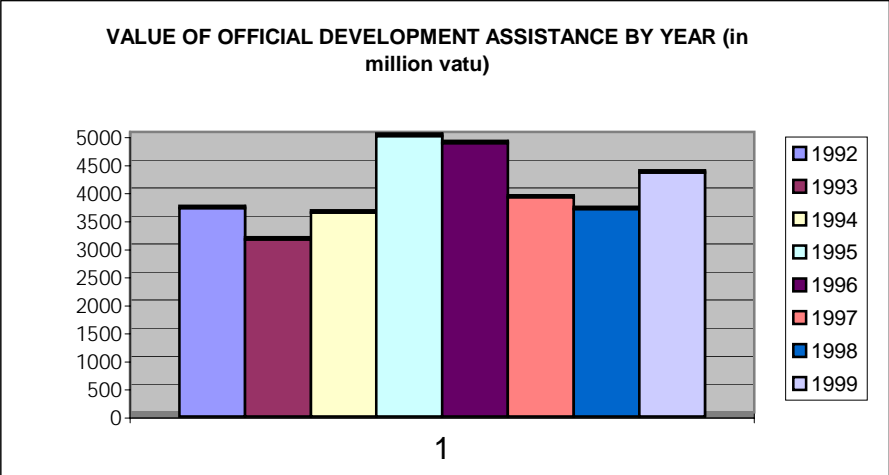
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<sup>27</sup> Bilateral organizations are: Australia, France, Japan, New Zealand, China, Britain, Canada, US Peace Corps

<sup>28</sup> Multilateral organizations are: European Union, Asian Development Bank, IDA, World Bank, IMF, United Nation Agencies, Pacific Regional Organizations



to some 21% of the current account receipts. Table 8 includes cash grants, aid-in kind, technical assistance and loans provided by the donor community which has significant influence on development, with resident offices of the UN, ADB, AFD and EU let alone representative bilateral agencies. The chart above provides the distribution of aid flows by year commencing from 1992 to 1999.



To show the economic significance of the official development assistance, Table 8 below provides the total amount of aid received by Vanuatu expressed as a percentage of GDP, Government Revenue and Expenditure during the 1990s. It is clear that foreign assistance plays a very significant role in supporting national development in Vanuatu. The magnitude of this development assistance is substantially more than half, and in some years accounting for more than two-thirds, of the value of Government Revenue and Expenditure. As can be seen from the table below, aid flows during the 1990s was erratic. Aid levels peaked in 1995 and slumped in 1993. Overall, development assistance declined in real terms in the 1990s as compared to the 1980s levels.

**Table 10: Economic Significance of Official Development Assistance By Year**

	1992	1993	1994	1995	1996	1997	1998	1999
<b>Total Foreign Aid ('000)</b>	3,716	3,154	3,630	5,471	4,869	3,904	3,698	4,346
<b>% of Real GDP</b>	28.4	23.1	25.9	38.7	34.5	27.5	24.9	29.9
<b>% of Govt Revenue</b>	68.3	59.2	59.1	78.6	71.3	56.9	52.4	59.7
<b>% of Govt Expenditure</b>	61.5	50.3	55.5	71.4	66.8	55.6	36.6	56.8

Source: Department of Economics & Social Development, Aid Database

Note: All values in vatu currency.  
About 130 Vatu = US\$1

By sector, about one-third of total ODA is being spent on the infrastructure sector comprising roads, bridges, wharves, airports, transportation systems, water supply systems, electricity, housing and telecommunications. Human resources and education, which has remained Vanuatu’s priority area for development since independence in 1980, consumed some 22% of total ODA while expenditure allocation designed to stabilize the macroeconomic situation accounts for a further 19%. During 1992-1995 period, the majority of aid (some 30%) went to supporting the Education sector followed by Health. Health during 1998-2002 period, was allocated only 6%. Vanuatu has given the private sector 3.2% of total ODA which reflects the

importance Vanuatu places on the sector's contribution to growing the economy. Foreign aid for agriculture accounted for 6.3% which will, in the foreseeable future, continue to dominate economic activity among the mostly 79% of the predominantly rural-based population. Tourism, although recognized as a potential for economic development and growth was either not attractive to development partners or tourism officials in the industry failed to draw-up good projects for development funding. That being said, caution must be exercised in the interpretation and accuracy of the data. Development assistance for tourism is known to be higher than what is being reported, but classified under education, private sector, infrastructure, etc. The difficulty in accurately estimating the tourism contribution is compounded by the absence in the SNA the tourism classification as a separate sub-sector. The European Union has been an active development partner in the tourism sector, supporting both the Pacific Regional Tourism Development Programme based in Fiji and the national programme managed by the National Authorizing Officer.

**Table11: Estimated Value of Official Development Assistance By Sector, 1998-2002**

Sector	Million Euro	Million US\$	Percent Distribution
Good Governance & Human Rights	0.5	0.425	0.32
Macroeconomic Stability	30	25.5	18.99
Law and Order and Justice System	3	2.55	1.90
Finance	2	1.7	1.27
Human Resources & Education	35	29.75	22.15
Health	10	8.5	6.33
HIV/AIDS	1.5	1.275	0.95
Gender Equity & Youth	0.5	0.425	0.32
Water & Sewerage	1	0.85	0.63
Energy	5	4.25	3.16
Infrastructure (Roads, Transports & Telecom)	50	42.5	31.65
Environment	0.5	0.425	0.32
Decentralization	1	0.85	0.63
Agriculture	10	8.5	6.33
Private Sector Business	5	4.25	3.16
Industrialization	0	0	0
Tourism	1	0.85	0.63
Renewable Resources	2	1.7	1.27
TOTAL	158	134.3	100

Source: Department of Economics & Social Development, Aid Database, Port Vila

Constraints and problems associated with external aid had been highlighted under Chapter One of this report as a constraint of not being able to achieving higher economic growth despite the levels of external aid.

### 3.15 External Financing and Public Debt

External concessional borrowing has been an alternative source of financing of development when grants are difficult to obtain. Vanuatu's debt position during the 1980s was favourable until only during the past ten years which saw a dramatic accumulation of debt, such that the ADB (1997 p.39) stated "*Clearly the current trend of adding 20 percent of GDP to external debt each decade is not sustainable in the long-run. Vanuatu will need to develop an external*

*debt strategy and carefully assess future borrowing to avoid the pitfalls that many other nations have fallen into".*

External debt grew from VT4.9 billion (16% of GDP) in 1997 to VT9.6 billion (35% of nominal GDP) in 1999. This level is not high by international standards but prudent management is required to curb the rapid growth given Vanuatu's narrow revenue and production base. Three ADB projects being proposed for loan funding are the Outer Island Infrastructure Development Project, Rural Finance Services Project and the Skills Development Project will increase the debt situation such that it would surpass the international average debt level (40% of GDP) for developing countries. This would raise questions as to whether Vanuatu could qualify for the HIPC special treatment. Additionally, increasing the debt level would not be consistent with the 1998 Financial and Economic Policy Statement of Government with a debt level target of 30% of GDP by 2000.

In an Executive Summary presentation to the Council of Ministers, the Department of Economics and Social Development within the Ministry of Finance & Economic Management advocated that:

- With existing loans the Government is unable to retire any debt in 2000. It now resorts to borrowing to finance debt repayments. This presents a grave picture that unless Government is forced to reduce its expenditure or raise additional revenue, the nation has reached its borrowing capacity in terms of its ability to service its debt.
- The current loans portfolio indicates that the next ten years the growth of the debt servicing bill will be 5.1% each year. This is higher than the long term economic growth rate projection of 3%. This again means Government must find new sources of revenue or impose budgetary cuts across Government in order to meet its current debt servicing obligations and provide essential social services to the populace.
- Over 80% (VT10 billion or US\$77 million) in absolute terms) of Vanuatu's debt is in foreign currency. This is relatively large and poses a foreign exchange risk. Pressure is expected to be applied on the foreign exchange rate (if not now then in future years) and this will effectively increase the debt servicing bill.
- Given this situation, Government must seek more grant funding for development rather than loans funding.
- If Government cannot obtain grant funding, and should the proposed project having undergone careful scrutiny is able to demonstrate a high rate of economic and financial return in the short-term, then Government can borrow. The domestic credit market should be the first place to look with external borrowing be considered only as a last resort.
- Because Vanuatu's debt has already been programmed to grow faster than economic growth, any new borrowing now will effectively worsen the debt situation.

**Table 12: Vanuatu Public Debt Situation and Trend By Category and Year  
(millions of Vatu)**

	1998	1999 Estimate	2000 Forecast	2001 Forecast	2002 Forecast
<b>TOTAL EXTERNAL DEBT</b>	6,739	7,197	8,937	9,744	11,813
Bilateral Debt	1,362	1,137	1,307	1,410	1,459
Agence Francaise de Developpment	748	739	694	655	619
China	614	399	609	755	840
Multilateral	5,377	6,059	7,634	8,779	10,354
Asian Development Bank	3,617	4,358	5,423	6,171	7,712
European Investment Bank	-	-	341	682	682
International Development Association	1,760	1,702	1,870	1,926	1,959
<b>TOTAL DOMESTIC DEBT</b>	2,157	2,461	2,461	2,461	2,461
Bonds	1,857	2,461	2,461	2,461	2,461
Reserve Bank of Vanuatu	300	-	-	-	-
<b>TOTAL DEBT STOCK</b>	8,896	9,657	11,397	12,649	14,273
% of nominal GDP	33	35	39	41	44
% of Government Revenue	126	133	162	175	190
% of Government Expenditure	88	126	63	58	53
% of Education Expenditure	18	18	16	15	14
% of Health Expenditure	9	9	8	8	7
% of Export Earnings	228	332	na	na	Na

Figures are based on signed loan agreements only. If ADB's proposed pipelined projects e.g Outer Island Infrastructure Project (US\$7.5 million), Skills Development Project (US\$1.5 million), Rural Finance Services Project (US\$5.0 million) and loan surfacing out of recent PPTA: Agriculture Sector Review – this would aggravate the debt situation.

Source: Department of Economics & Social Development and Department of Finance

As can be seen from Table 10, Vanuatu's debt accounts for two-thirds of the country's GDP, and is significantly larger (by 133%) than Government recurrent Revenue and was estimated to be higher (by 126%) than Government Expenditure in 1999. The level of debt far exceeds, by two times in 1998 and three times in 1999, the value of domestic export earnings. This calls for immediate prudential management of the public debt position by Government and for the long term, a debt strategy should be formulated as a matter of priority.

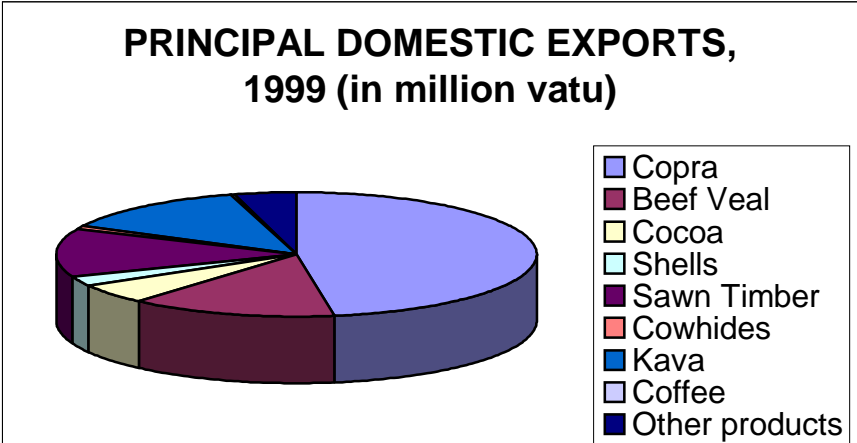
It has been proposed in the 2000 Fiscal Strategy Report published by the Ministry of Finance & Economic Management that due to increase in debt servicing requirements, explicit provision will be made in 2002 to retire domestic debt. This ensures that there is at least some reduction in the debt stock level over time and maintaining the amount of liquidity in the system.

### 3.16 The Export Sector

The external account of Vanuatu is very fragile and is dependent on a narrow range of exports, tourism and aid flows, including loans. Consistently throughout the 1990s, the trade account recorded trade deficits with the exports sector accounting for about one-third of total imports, and is subject to substantial variation reflecting the vulnerability of the export performance and commodity prices.

Vanuatu's exports are primarily agriculture-related products as highlighted in Table 2 of page 4 of this report and the pie chart below. Clearly copra accounts for almost 50% of total exports in 1999. Other products make up the remaining 50%. Exports performance during the

1990s has been buoyant growing at around 10%, but took a nose dive in 1999 due to fallen copra prices and the impact of the changes in the weather pattern. The buoyant performance reflects Vanuatu’s vulnerability to changes of the terms of trade, frequent occurrence of cyclones and its heavy dependence on a few narrow range of commodities. These commodities are easily damageable during cyclone devastation. Poor performance in the export sector has a direct impact on the value added of the agriculture sector.



One constraining factor is the lack of export diversification and the country’s inability to exploit fully the potential in turning around primary subsistent products into commercially cash-oriented ones. According to the 1983 National Agricultural Census, almost 100% of those enumerated indicated the willingness to increase production if niche markets for their products are found. This constraint has not fully been addressed by the country thus far. Only recently UNCTAD commissioned a Consultant to prepare a framework for development of an Export Development Strategy. The framework has been prepared for Government’s consideration and approval.

The trade deficit in 1997 was –6,801 million Vatu (US\$52.3 million), which means that the imports value represents about 166% higher than the value of exports, while the balance ratio was 0.38. This position has deteriorated so that in 1999, the trade deficit worsened so that the value of imports is higher by 274% than exports value. This situation can deteriorate further if a national catastrophe occurs. The export sector only covers less than half of the value of imports. The trade deficit is offset to some extent by international surplus in relation to services (importance of inbound tourism) and some official development assistance. International tourism is also a volatile industry and given Vanuatu’s situation of ownership of main tourist infrastructure, it is believed that the benefits of tourism has significant import and foreign exchange leakages given Vanuatu’s system of having no exchange control. An in depth study into tourism development is recommended.

3.17 Foreign Direct Investment

New direct investment by foreign business in Vanuatu has been sluggish in recent years, and reforms have been implemented to encourage greater inflows of direct investment. Although Vanuatu often advocated attracting foreign investment into Vanuatu its actions and established framework are uninviting and at a particularly low point during the 1990s. Vanuatu lacks a clear foreign investment policy (as identified by DP3), bureaucratic requirements are excessively cumbersome – which appears to be a disincentive to foreign

investment and costs of establishment and maintaining business in Vanuatu are high. But for a small country, Vanuatu has a sizeable level of foreign investment, with major sector businesses operated by foreign concerns, which suggests that Vanuatu is an attractive host to foreign business (ADB: 1997).

No statistical information is available on foreign direct investment on Vanuatu before 1998. The Vanuatu Foreign Investment Board (VFIB) established only in late 1998 was designed to improve the foreign investment environment. In its 1999 annual report, VFIB reported that, from September 1998 to December 1999, it approved 156 applications out of 171 foreign applications received. If the statement in the applications are to be relied upon, these applications would represent VT13 billion (US\$100 million) worth of foreign investment and 2,700 new jobs was to be created.

Of these applications only 16% valued at VT2.1 billion or US\$16.2 million actually got invested which created 519 additional employment. Many of the businesses (most are new investments) implemented were relatively small in terms of value of investment with most of the larger businesses that require sizeable land are still being negotiated. The problem constraining the full implementation of foreign business proposals (remaining 84%) was four-fold:

- Land being proposed for investment is being disputed by traditional land ownerships;
- Business proponent still negotiating duty exemptions on importation of materials;
- Awaiting the authority to conduct environmental impact assessments; and
- Once approval is obtained by the VFIB Board, foreign investor failed to start.

**Table 13: Foreign Businesses By Sector and Value, Sept 1998-Dec 1999  
(in million vatu)**

Sectors	Value of Proposed and Approved Investment	Value of Implemented Foreign Investment
Agriculture	446	NA
Aquaculture	64	8
Education/Health	170	2
Fisheries	269	NA
Finance	547	191
Forestry	1,071	NA
Manufacturing	3,972	1,083
Real Estate	167	122
Shipping	302	9
Tourism	5,253	244
Wholesale and Retail Trade	350	404
Other not elsewhere classified	488	25
<b>TOTAL</b>	<b>13,155</b>	<b>2,088</b>
Investment Ratios (as % of GDP)	48%	8%
Investment Ratios (as % of ODA)	303%	48%

Source: Vanuatu Foreign Investment Board, 1999 Annual Report

The legal entity, the Vanuatu Foreign Investment Board (VFIB) entrusted with the responsibility of promotion and facilitation of foreign investment has been established. UNCTAD (Jegathesan) in its unpublished report, *Strategic Development For Economic*

*Recovery*’ was critical of VFIB Act as being ‘not investor friendly’ which could become a major disincentive to attracting FDI. The high utility costs (power, water, telecommunications, shipping, air, etc) provides a disincentive environment for attracting FDI. *The high cost of virtually all goods and services in Vanuatu is a paradox in a country designated as less developed. The cost of simple consumer items from vegetables and fruits, to bread and meat sometimes appear to be even higher than those in some developed countries. (Jegathesan UNCTAD: 2000)*

Jegathesan concluded that “Where such costs cannot be reduced, then the investment environment should become so efficient and productive that the cost factor becomes a secondary issue in the calculations of foreign investment”.

### 3.18 Regional Cooperation Dimension

Presently, Vanuatu has membership of 70 international and regional organizations. In the Pacific region, Vanuatu is member of seven inter-governmental regional organizations viz. South Pacific Forum, Pacific Community Secretariat (SPC), South Pacific Regional Environment Programme, South Pacific Tourism Office, South Pacific Geo-science Commission, Forum Fisheries Agency and the University of the South Pacific. Vanuatu receives from these organizations technical assistance, materials, training and capacity building, cash grants, etc. Vanuatu relies somewhat on these regional institutions particularly in respect to training of its future human resource, in its strive towards social and economic development. Additionally, donor partners particularly Australia, New Zealand, Japan, France, Britain, European Union, China and a few others offer special regional development programmes in environment and conservation, health, tourism, security and surveillance, education and training, etc for Pacific countries from which Vanuatu benefits.

Whilst the benefits from these organizations are variable, the financial burden of servicing these memberships are substantial such that Vanuatu appears to have reached the limit of meeting its membership obligations. Every year Vanuatu’s direct costs of memberships amount to about VT70 million (US\$538,500) membership costs combined with the requirement to attend organizational meetings cost an additional estimated VT50 million (or US\$384,500). In total Vanuatu is expected to expend about a million dollars each year. A review was appropriately commissioned to consider the cost-effectiveness of Vanuatu’s memberships of international and regional organizations from which Vanuatu has yet to implement the recommendations.

### 3.19 Vulnerability to Shocks

Vanuatu’s vulnerability to natural disasters was estimated by the Commonwealth Secretariat to be ranking highest among 111 observed developing countries, on the basis of the percentage of population affected by disasters during the 1970-1996 period. Natural disasters have a direct impact on depressing export earnings. With population growth at 3.0% per annum under the context of vulnerability, the high frequency of weather-related disturbances in Vanuatu is anticipated to have an increasingly serious socio-economic impact in the future. In its report on Vanuatu’s Vulnerability Profile, UNCTAD stated “*Though not suffering from high output volatility, Vanuatu is severely hampered by external shocks in its efforts to improve economic structures, both in terms of sectoral specialisation and with regard to structural handicaps. Economic specialisation over the 1985-1997 period underwent little change although the share of international services in total exports of goods and services increased from 51.3% in 1985 to 68.2% in 1997*”. This is a result of good performance of

business services such as the Offshore Finance Centre and other business services concentrated in the capital.

UNCTAD further states, *'The structural economic handicaps that Vanuatu like most other small island developing states suffers from essentially relate to the disadvantages of smallness and remoteness, and are aggravated by the geographical dispersion of the islands making up the Vanuatu archipelago.'* Vanuatu is prone to a high frequency of natural disasters<sup>29</sup> and is also affected by shocks of non-natural origin. These shocks have impacted on the stability to maintain agricultural production and exports as well as affect the performance of the tourist industry.

Post disaster relief assistance is largely being met from donors at the expense of some projects being delayed for future implementation. The national Government has not throughout the 1990s appropriate special allocations in its annual budget for disaster relief assistance until the 2000 budget where an amount of VT40 million (US\$308,000) was allocated. Distribution of disaster relief assistance is hampered by the duration of inter-island shipment. This exercise can be extremely expensive if helicopters or planes are employed in distributing medical and food items. While immediate response to humanitarian needs can be met within a few days, long term rehabilitation programmes for infrastructure (roads, bridges, schools, wharves, ports, etc.) can take several years before works start.

Vanuatu inevitably suffers from world changes in the terms of trade of its major commodities such as copra. Any adverse changes in the terms of trade will depressed Vanuatu's exports earnings as it only depends on a narrow range of agriculture-based commodities. Included under section '3.16 The Export Sector' are some narratives on the terms of trade. During the 1990s, the following events caused financial instability:

- the VNPF pay-out of all members' funds caused an increase in liquidity which forces the RBV to take appropriate measures to absorb the excess liquidity (details is mentioned under 'Public Service Strike and VNPF Riot', page 15). This was also a time of political uncertainty which left businesses not able to predict Government's policy – which could have caused sizeable exports of cash overseas, given Vanuatu's system of no exchange control measure.
- The absorption of foreign currency loan (in US dollars) for the Comprehensive Reform Programme which has a potential of destabilizing the Balance of Payments situation in the long term. This situation is bound to be aggravated during the period when loan grace period is due and the Government expected to commence repayment.
- Upon entry of the new Government around end of 1999, the RBV restricted the sale of foreign currencies to individuals, except for businesses.

All above would create a BOP deficit in the future.

In recognizing its vulnerability to natural disasters, Vanuatu established a National Disaster Management Office directly responsible for awareness raising, disaster preparedness and training and emergency and post-disaster relief assistance. On the basis of a recent study, ESCAP formulated a strategic disaster management programme, 'Vanuatu: Comprehensive National Disaster Management Programme' which has yet to be endorsed by the Council of

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<sup>29</sup> Table 3 of this report provides information on major cyclones and their socio-economic impact and Table 4 gives you data on major earthquakes since 1980;



Ministers which aims to reduce Vanuatu's vulnerability to the effects of both natural and man-made disasters. Disasters can have very serious impacts on the financial position of the Government as well as development partners normal programmes. During the 1990s, nine major cyclones and four major earthquakes (see Tables 3 and 4) devastated Vanuatu. It was clear from the tables indicated that such magnitude of destruction can seriously affect a nation's normal development path. During the emergency and rehabilitation phases normal programs were halted to divert resources towards disasters. In this situation, both the Government and development partners import at will duty free emergency and rehabilitation materials for consumption and reconstruction, thus creating balance of payment difficulties.

Vanuatu has now endorsed the Kyoto Protocol to the United Nations Framework on Convention on Climate Change which requires developed countries to reduce and control their overall emissions of the major GHG's by at least 5% below that of the 1990 level by between 2008 and 2012. Signatories to the Convention obligates countries to abide by the convention and prepare national programmes to address the climate change. Vanuatu, like any other small island state, is very vulnerable to global climate change, climate variability and sea level rise. The South Pacific Regional Environment Programme (SPREP) has a regional programme designed to address the issue together with its South Pacific member countries. Because of human resource and financial constraints, it is essential that the financial mechanism and other assistance of the UNFCCC and the Global Environment Facility be continued.

Pursuant to the Kyoto Protocol<sup>30</sup>, subsidiary bodies comprising of all LDCs engaged in informal consultations in addressing specific needs and concerns. It was felt by the Group that LDCs should be accorded special treatment in the implementation of support programmes because of their limited adaptive capacity. New funding avenues with fewer institutional complexities, smaller overheads or bureaucratic hurdles should be sought. Final output on the implementation of Article 4.8 and 4.9 of the Convention, and on matters relating to Article 3.14 of the Kyoto Protocol, pertaining to guidance to the financial mechanism would be forwarded to the relevant contact group once agreement has been reached.

Annex Three of this report highlights draft elements of a work programme relating to Article 4.9 of the Convention as well as other obligations under the Convention and the Kyoto Protocol. Contained therein is also a National Adaptation Programme of Action (NAPA) designed jointly by all LDCs purposed to enable LDCs communicate their vulnerabilities and adaptation needs relative to the Kyoto Protocol and the Convention.

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<sup>30</sup> Implementation of Article 4.8 and 4.9 of the Convention (Decision 3/CP.3 and Article 2.3 and 3.14 of the Kyoto Protocol) and Matters relating to Article 3.14 of the Kyoto Protocol.

## **CHAPTER FOUR: EXAMPLES OF SUCCESSES AND BEST PRACTICES**

During the decade, about VT35 billion (US\$269 million) worth of development aid was spent for development purposes for Vanuatu. It is important to take stock of these developments and highlight practical examples of policies and programmes that achieved, to some degree, the objectives for which they were introduced. Vanuatu, like other LDCs, have experienced cases of success stories of development. Below are brief synopsis of some of the recent more successful programmes:

### (1) Vanuatu Women's Development Scheme (VANWODS)

This micro-credit scheme operated by the Department of Women's Affairs is funded by UNDP through its regional programme, Sustainable Microfinance and Livelihoods through Empowerment. The project is designed to demonstrate a methodology for delivering a sustainable, non-collateralized loans and savings program for low income households in the urbanized area of Port Vila, especially targeting disadvantaged women. The project was implemented in response to growing concern on the rise of income inequality and unemployment, especially in the urban and peri-urban areas in Vanuatu, and against a legacy of many failed and unsustainable micro-credit schemes and revolving fund programs aimed at stimulating self-employment. This project was initiated in the face of generally held view that the poor are not credit worthy, lack enterprise capabilities, cannot and will not save, and without the discipline and motivation to participate in any developmental programme requiring long term commitment.

The scheme has a 100% repayment rate and provided direct employment for about 400 poor women. The scheme not only generated a strong commitment to savings and borrowings, it also has generated intangible accomplishments which include the improvement in the productive capacity of until now non-economically active women housewives, improved standard of living for their respective families, improved family relationships, successful cultivation of entrepreneurial attitude and business skills, and most importantly the recovery of lost self-esteem. In an independent assessment of the scheme, Garry Wiseman<sup>31</sup> stated *"VANWODS has brought together 400 poor women, who live in and around Port Vila but who originate from many parts of the country. Through the organization these women have formed new friendships and established support networks that go well beyond the functions of saving and lending money. In the future these women could act as very good 'ambassadors' for the scheme working with the women of their home island or village to encourage new members.*

*Borrowing and saving money was foreign to almost all of the women. However through training, which is a prelude to participation in the scheme, there is a universal acknowledgement that all loans must be repaid. The 400 women are divided into centres of five women, with six centers making up a group. Loans are repaid through each centre and this provides an incentive for individuals to meet the obligations for all. No one in the centre can get a further loan if the centre's overall repayment schedule is not met.*

*The 400 women members of VANWODS have been able to pursue new opportunities and increase their chances for their children in education and future employment. In some cases*

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<sup>31</sup> Mr Garry Wiseman carried out the independent Country Assessment Report.

*VANWODS has provided the safety net for the CRP. Women have been able to supplement the family income lost when the main breadwinner was made redundant under CRP.*

*For one of the women interviewed, her new enterprise has been able to employ her out of work husband. While another, her business has expanded to include furniture making, a sideline activity pursued by her husband. Others are taking advantage of the chance to start small retail outlets and while some encounter the many problems faced by a small business they are still experimenting and learning from each other.*

*With the voice of 400 they have been able to get changes in Government policies on Business Licenses for the informal sector and in having micro-finance organizations classified under the Charitable Associations Act.*

*Although only going a couple of years 19 families, where women in the household are involved in VANWODS, have been able to move out of their squatter area and are now purchasing their own land on the outskirts of Port Vila.*

*The interview with just these six women highlighted the importance of providing people with an opportunity, and because they are poor and see very little of the development money flowing into the country, they embrace the chance and take nothing for granted.*

*Finally, a long-term benefit of this type of project is that in through learning about being accountable for money and for each other the women also learn more about the business of politics and understand better issues of governance and the need for Government's and public service to be accountable. Therefore, a side benefit is that they can then more fully contribute to the political debates and make a more informed decision about how they want their country to be run."*

## (2) Market House

The construction of the Port Vila Market House, funded by Agence Francaise de Developpment (AFD), and its current usage is a success story. The Market House, managed by the municipality, was constructed to facilitate poor agriculture-based women to sell their produce to mostly urban buyers. An average of VT40,000 per trading day is collected by the municipality from the women for use of the premises. On the basis of this information, the market's annual turnover can be estimated to be around VT10 million (65,000 Euros). It is guesstimated that the women derive far more than this indicated amount. In consideration of expenditure, the market operates above break-even at present operating level.

The project was so successful that the Government has already successfully negotiated and signed an agreement with AFD for the extension of the market house given the increase in trading days from 3 to 6 and to accommodate the increasing number of women traders (about a third of maximum of 100) selling their produce outside the market house.

## (3) Successful Health Programmes

Some health policies and programmes have to some extent been successful. The improvement of life expectancy, declining in infant and adult mortality rates, declining maternal mortality, increased contraceptive prevalence rate, etc. are some of the indications of successful health programmes.

(i) The malaria control programme is one of them. Malaria, a disease caused by a single-celled parasite of the genus *Plasmodium* which is transmitted to humans through the bite of the female anopheles mosquito, is prevalent mostly in Melanesian countries such as Papua New Guinea, Solomon Islands and Vanuatu. As malaria remains a significant public health problem in Vanuatu, efforts were made to control the disease. The programme was designed to:

- (a) eliminate the risk of malaria to the population through the use of insecticide-impregnated mosquito nets, chemotherapy, vector control and health education;
- (b) reduce the incidence of malaria from about 27 cases per 1000 population to less than 10 cases per 1000 population and maintain malaria mortality rate at zero death per annum by the year 2007.

In 1983, 20.6% of the population contracted the disease compared to only 3.4% were affected by malaria in 1997. This reveals a gradual decline in the incidence of malaria. Monthly data shows that malaria recurs after high rainfall periods.

(ii) HIV/AIDS Prevention Program is another successful health programme. Incepted in 1987 with financial support provided by WHO under its Global Program on AIDS until 1995 when UNAIDS took over funding responsibility. The control program was incepted in 1987 in response to the growing global epidemic.

A national policy on HIV/AIDS was drawn up and used successfully although it was not legally binding. National awareness programs and activities were successfully implemented. In 1996, a sample size of 1,504 people were tested for HIV for which none was identified positive. Increasing mobility means the spread of the disease into Vanuatu is only a matter of time. HIV testing among high risk behaviour groups has been limited, it is possible that HIV infections may already exist among the population. A growing tourist industry, increasing numbers of ni-Vanuatu travelling abroad and rural-urban migration, increasing number of teenage pregnancies and the high prevalence of gonococcal infections and other reproductive infections all suggest a high potential for HIV transmission.

(4) Island Safaris – This tourism project was overallly designed to improve commercial viability and management skills of ni-Vanuatu bungalow operators in Vanuatu. It aims to do this by:

- Increasing market demand and volume of tourists to rural areas;
- Improvement management skills and levels of customer service at the small bungalow resorts;
- Increasing revenue levels and profitability for small bungalow resorts;
- Integration of the rural tourism sector into destination marketing of Vanuatu;
- Increasing the distribution of the rural resorts sector through wholesalers and travel agents in key market areas through the 'Island Safaris' brand;
- Development of the Rural Tourism Support Centre to provide a centralized booking facility on a commercial basis;
- Increasing awareness of the small bungalow resorts among consumers through 'Island Safaris' brand;
- Facilitating product development among small bungalow operators.

The project was successful in establishing the Vanuatu Island Bungalows Association (VIBA) and the Rural Tourism Support Centre to coordinate bookings and support to bungalow operators, delivery of continuous training to operators in management, marketing,

product development, food preparation and financial management, development of Island Safaris as vehicle for distribution of bungalow product and the development of promotional material and engage marketing activities on behalf of the bungalow operators. The membership base of VIBA increased by 25% inclusive of the local domestic airline.

- (5) Education – Rehabilitation of 36 primary schools and 5 Regional Education Officers' Workshops was possible through funding assistance provided by European Union under the 7<sup>th</sup> European Development Fund. The purpose of this project was to contribute to the improvement of primary education in rural areas in consistent with the Third Development Plan which focuses on sustainability and decentralisation of education services with use of School Committees and reinforcement of the Regional Offices.

The Government's commitment to reducing the development gap between rural and urban areas should be possible through the implementation of this European Union/Vanuatu Government education infrastructure investment and maintenance. The project assisted in formulating a sound and effective maintenance programme for the whole educational infrastructure, constructed rehabilitated buildings to conform to the criteria of National Building Code to ensure appropriate level of safety against frequent natural disasters, maintaining environmental impact within acceptable levels, conformity with prevailing socio-cultural factors and that the school buildings would be operated and maintained in the cost-effective manner.

The important features of the successful project was that:

- Local constructors were utilized who provided quality and speedy input into the project implementation;
- In the process local construction companies are exposed to European Union funding procedures;
- Funds totaling VT422 million was absorbed by the local economic system which assisted the country in its efforts to redistribute income equally to all parts of society particularly those in rural areas.

## CHAPTER FIVE: PROGRAMME OF ACTION

### Objective

The over-riding objective of this programme of action during the current decade is to raise the level of self-reliance and improve the quality of life for all sections of the population. This policy objective aims at optimizing economic growth, poverty reduction, environmental protection, balanced regional development, peace and stability, equity and such other considerations.

### Vision

Vanuatu has today accepted the vision statement incorporated in the CRP document with a time span of some 20 years. This vision underwent wide consultation with all sections of the community before adoption. This statement is provided below:

- *The foremost element of the shared vision is national cohesion. This embraces a desire for existing divisions of wealth, geography, gender, age, language and power to be subordinated to a sense of common destiny.*
- *It also embraces a desire to build a well-governed, truly democratic nation of which all its citizens can feel proud.*
- *In order to build such a nation it is necessary to achieve economic prosperity, for the nation as a whole and for all its members. Future generations are not forgotten in this part of the vision, whose prosperity depends on the wisdom of the present generation and its leaders in the way they govern and manage the nation's resources.*
- *Most ni-Vanuatu have minimal control of their own lives and a narrow range of choices open to them. An important part of the vision is empowerment of individuals, families and communities.*
- *The only sure means of empowerment is education and training. Vanuatu needs a well-educated population. It is well recognized with the education system, with its language-based diversity, has failed to deliver even an acceptable level of literacy. No long-term improvement in living standards and quality of life is possible without radical improvement in education and training.*
- *A steadily improving and accessible system of health care is equally important. As medical science advances, peoples' expectations will rise. As the number of old people grows, demands on the health system will increase.*
- *In nearly all respects the quality and accessibility of the nation's infrastructure must improve, which means that resources must be found continually upgrade and maintain it.*
- *While it may be unrealistic to expect living standards in all parts of the country to converge overnight, the common vision does involve a steady erosion of existing disparities between islands and, more particularly, between the rural areas and towns.*
- *Economic development is often thought of to be necessarily destructive of traditional values and culture. This must not be the case for Vanuatu's CRP. Retention and positive development of traditional values and culture is an essential part of the shared vision.*
- *Similarly it is essential that the physical environment be protected for the sake of our descendants as well as for ourselves. This is in harmony with the traditional relationship between the ni-Vanuatu and their land.*

### Strategy

In a strategy towards addressing this vision, Vanuatu identifies four key areas of policy that require immediate attention. Through the CRP, policy frameworks have been designed to

address all four areas which are understood to be mutually reinforcing. These policies are designed to be applied in combination with one another.

- *Stable government, which includes macroeconomic stability and good governance. Both are required to reduce business risk. Investment is deterred both by unpredictable changes in macroeconomic settings (interest rates, exchange rates, tax rates) and also by the risk of arbitrary and unexpected government interventions.*
- *Education and training. These raise the skills base and business and technical “know-how” available in the economy (increasing “human capital”).*
- *Policies that encourage private sector dynamism. These must include policies to ensure the availability of land for productivity purposes; access to capital for investment; adequate infrastructure; and a legal and regulatory regime which minimizes the costs of doing business.*
- *A high degree of openness to the global economy, to encourage a greater flow of risk capital and associated technical expertise, wider markets for exports, educational contracts...”*

All four areas of policies are comprehensively covered in the CRP Action Matrix attached at the Annex. The Programme of Action Matrix includes details on the strategies envisaged.